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Print Edition January 26th 2002

Ready for take-off?
America's heavy debt burden will hinder a full economic recovery ... More on this week's lead article

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Politics this week

Jan 24th 2002
From The Economist print edition

Prisoners' dilemma, continued

Reuters

Donald Rumsfeld, America's defence secretary, dismissed European criticism of the treatment of al-Qaeda and Taliban prisoners airlifted from Afghanistan to a camp in **Guantanamo Bay**, Cuba, and rejected calls to have them classified as prisoners-of-war. Chris Patten, Europe's foreign-affairs commissioner, said “justice, not vengeance” should be the guideline in dealing with the prisoners. John Walker, an American Taliban soldier, appeared in court in Virginia.

See article: The argument about Camp X-Ray

The anthrax-hit Hart Senate Office Building reopened after 95 days of decontamination. It now seems that 70 people in the office of Tom Daschle, the Senate majority leader, were exposed to **anthrax** spores of up to 3,000 times the fatal dose for humans.

The United States and Britain are close to a controversial deal that would end **Libya's** status as a sponsor of terrorism. The agreement would include a compensation payment of up to $6 billion by the Libyan government for the 1988 bombing of Pan Am Flight 103 over Lockerbie in Scotland in which 270 people were killed. The Libyan sentenced for planting the bomb began an appeal against his conviction.

Escalating violence

Violence escalated steeply in **Israel and the Palestinian territories**. Palestinian gunmen killed eight Israeli civilians in Jerusalem and Hadera. The Israeli army invaded Tulkarm and Nablus, where it killed four senior Hamas men. Hamas spoke of “all-out war” and Israeli intelligence men gave warning of unprecedented terrorism.

See article: The cycle of Israeli-Palestinian violence

Iran released nearly 700 **Iraqi prisoners**, most of whom had been held since the 1980-88 Iran-Iraq war. Thousands more are believed still to be held. Iran is to restart flights to Iraq and Iraq's foreign minister was due to visit his Iranian counterpart in Tehran on January 26th.

See article: Iraq and its neighbours

An anti-corruption trial opened in **Iran**. The chief defendant, Shahram Jezayeri, a young entrepreneur, is accused of bribing officials.

EPA

Food and blankets started to arrive in the Congolese town of Goma, where thousands are hungry and exposed after a **volcanic eruption** destroyed their homes and buried their fields.

See article: Eruption in Congo

African journalists had a rough week. An Angolan reporter was fined for defaming president José Eduardo dos Santos. A Sudanese editor was fined for “publishing false news”. In Zimbabwe, a bill aimed at muzzling the media was delayed, but may return.

In **Nigeria**, a sharia court judge was flogged for drinking alcohol.

Out of Kosovo

Michael Steiner, a former adviser to Germany's chancellor, Gerhard Schröder, was appointed the UN's man to run **Kosovo**, after the early departure of Hans Haekkerup, a former Danish defence minister.

See article: Kosovo's hapless new UN proconsul

A row over the **Czechs'** new nuclear power plant at Temelin, near the Austrian border, resumed after Jörg Haider of Austria's far-right Freedom Party, a partner in the country's ruling coalition, again said it should be closed. The Austrian government had recently agreed to a compromise that would leave it open. The Czech prime minister called for the Freedomites to be chucked out of government.

See article: Austria's coalition government may be fraying

Eduardo Ferro Rodrigues became leader of **Portugal's** ruling Socialist Party, two months before a general election. His predecessor, Antonio Guterres, will stay on as caretaker prime minister until then.

See article: Portugal's Socialists

Russia's last opposition television channel with a national reach, TV-6, closed down—for commercial reasons, said its owner, an oil company; because of Kremlin pressure, said most others.

See article: Russia's last independent television channel

Italy's prime minister, Silvio Berlusconi, appointed his deputy prime minister, Gianfranco Fini, leader of the post-fascist National Alliance, to represent his country at Europe's constitutional convention that starts in March.

See article: Europe's awkward squad

Murdered mayors

In **Brazil**, the mayor of a Sao Paulo industrial suburb and adviser to Luiz Inacio Lula da Silva, the presidential candidate of the opposition Workers' Party (PT), was kidnapped and killed. His murder, the second of a PT mayor in Sao Paulo state in four months, raised fears that a death squad was operating, and highlighted Brazil's worsening problem of violent crime.

See article: Violence in Brazil

Colombia's government and the left-wing FARC guerrillas agreed on a detailed timetable for negotiations aimed at achieving a ceasefire by early April. With that, President Andres Pastrana renewed for a similar period the life of a controversial guerrilla-controlled “demilitarised zone”.

Argentina's government said that dollar bank deposits would be returned to savers in pesos, backing away from an earlier promise to honour them in full. It also announced its setting up of a panel of international economists and officials to help formulate a new economic policy.

See article: Argentina's crisis

In **Venezuela**, tens of thousands of people took part in a march to call for the resignation of President Hugo Chavez. The president's supporters staged a smaller counter-march.

Blood money

Afghanistan was promised aid worth $4.5 billion over five years by representatives of donor countries meeting in Tokyo, with $1.8 billion available in the next 12 months. With fighting reported between tribes in at least two areas of the country, there were calls for the money to be controlled by the UN, to prevent it enriching local leaders.

See article: Pledging aid for Afghanistan

Four Indian policemen died when gunmen attacked a United States cultural centre in **Calcutta**. Pakistan denied an Indian claim that its intelligence services were involved in the attack. The UN's chief, Kofi Annan, on a visit to Pakistan, said that he hoped the “worrying” attack would not escalate tension between the two countries.

Reuters

See article: An attack in India

In a new move against separatism, police in **Indonesia** shot dead Abdullah Syafei, a leader of a movement seeking independence for the province of Aceh.

China disciplined 175,000 officials last year for crimes including corruption, according to the government news agency. Over the past few years a number of Chinese officials have been executed for corruption.

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Business this week

Jan 24th 2002
From The Economist print edition

Accounting for Enron

Enron's embattled chief executive, Kenneth Lay, resigned after a creditors committee had urged his removal. Mr Lay had founded the Texan energy-trading giant and continued to express optimism about its future even as it headed into bankruptcy.

See article: Commercial banks after Enron

Investigation of **Andersen's** role in the **Enron** scandal centred on the involvement of the accounting firm's head office in the destruction of documents. The FBI and Department of Justice began investigations on site. Andersen has portrayed the shredding as an initiative taken by its Houston office.

See article: The debacle only gets worse

Tyco, an acquisitive conglomerate that has raised concerns with its accounting methods in the past, announced that it would split into five to realise the company's true value. Its shares have languished, especially since Enron's demise. It will spin off its health-care, fire protection and financial-services businesses, and sell plastics outright but it will retain its telecoms, security and electronics concerns. The cash, estimated at over $11 billion, will be used to pay off debt.

See article: Face value: Dennis Kozlowski

Amaze.com

After six-and-a-half years and losses of some $3 billion, **Amazon** amazed the markets by making a profit for the first time. The leading online retailer added to the shock by revealing that it was a genuine net profit—albeit of just $5m—rather than a previously promised “pro-forma operating profit” (ie, another loss).

Kmart, America's second-largest discount retailer, filed for Chapter 11 bankruptcy protection. After an unsuccessful restructuring and bad Christmas trading its debt-rating sagged and its share price had plummeted to 38-year lows.

Daiei, a Japanese supermarket group, suffered a 30% drop in its share price and a lowered credit rating after it unveiled restructuring plans that failed to impress. A hefty injection of cash from its bankers and tacit pressure from Japan's government may yet lift the threat of bankruptcy.

Just browsing

AOL Time Warner sued **Microsoft** in the battle of the Internet browsers. AOL's Netscape once monopolised computer desktops until it was unseated by Microsoft's now dominant Internet Explorer. AOL, while doubtless rueful of its lost position, merely seeks heavy compensation and the opportunity to compete.

See article: Who's afraid of AOL Time Warner?

CSFB agreed to pay $100m to settle an investigation by America's regulators into claims that it had

rigged IPOs of high-tech shares during the dotcom boom, by allocating big tranches to favoured customers in return for a slice of the profits through inflated commissions. Other banks are believed to be facing questions about similar practices.

See article: CSFB settles allegations

Battle at sea

An improved offer for **P&O Princess** of £3.5 billion ($5 billion) by **Carnival Corporation** failed to scupper P&O's planned merger with **Royal Caribbean Cruises**. P&O, the world's third-largest cruise company, may yet wring more cash out of Carnival, the world's biggest, but a merger with Royal Caribbean, the world number two, would attract less regulatory resistance.

Greece's two largest banks, **National Bank of Greece** and **Alpha Bank** called off a merger after Alpha's top managers objected to the division of jobs between the two banks' employees. State-controlled National Bank had apparently sought more influence at the last moment.

Craig Venter, a scientist and co-sequencer of the human genome, resigned as president of **Celera Genomics**, a biotechnology company that he helped to found, to make way for someone with more management experience. He will remain chairman of Celera's scientific-advisory board.

Energy diminished

Exxon Mobil said that profits had fallen by 49% in the fourth quarter to $2.7 billion. A fragile world economy sent both oil demand and prices tumbling.

BG, a British gas company, along with Italy's Edison and Egyptian partners, found a buyer for some of Egypt's abundant natural-gas reserves. Gaz de France agreed to buy $8 billion worth of liquid natural gas over the next 20 years. Other leading energy companies are also set to exploit Egypt's gas fields.

Down with the yen

The **yen** hit a three-year low against the dollar, going above ¥134. Japan's government is hoping that relief from deflation may result. But America's treasury secretary, Paul O'Neill, visiting Tokyo, said that letting the currency slide would not in the long run substitute for economic restructuring. He noted that “a falsely manipulated currency is a form of protectionist action.” South Korea was even less circumspect, calling the policy “dangerous”.

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World economy

Ready for take-off?

Jan 24th 2002
From The Economist print edition

America's heavy debt burden will hinder a full economic recovery

THE latest data suggest that America's recession may be almost over. Consumer confidence has rebounded and the Conference Board's index of leading indicators rose strongly in December for the second month in a row. Wall Street economists are eagerly revising up their growth forecasts. Yet the excesses of the 1990s boom, notably the surge in household and corporate debts, still loom dangerously large. Like a bird that has stuffed itself with too many worms, America's debt-laden economy will find it hard to get fully airborne.

That would be a big setback for the world economy, which is still overly dependent upon America. Japan appears to be sinking deeper into deflation; its banks are teetering on the brink. Europe as a whole (though not Germany) has avoided recession, but it hardly looks like a powerful engine of global growth. In contrast, the cheery view of America's recovery is based on the perception that companies have been quick to prune excess inventories and cut surplus capacity, paving the way for a rebound. Consumer spending, meanwhile, has remained surprisingly buoyant.

The doom-mongers (including *The Economist*) who predicted a deeper downturn have, many argue, been proved wrong. Perhaps. But what the optimists have lost sight of is that America's recession was caused neither by the events of September 11th nor, like every previous post-war recession, by tightening by the Federal Reserve in response to rising inflation. The root cause of this recession was the bursting of one of the biggest financial bubbles in history. It is wishful thinking to believe that such a binge can be followed by one of the mildest recessions in history—and a resumption of rapid growth.

Fuelling the recovery

In the fourth quarter of 2001 American companies slashed their inventories by more than they had ever done before. A turnaround in inventories may therefore boost output in the first quarter of this year. But for a sustained recovery, consumer spending and business investment need to take over. Here lies the problem: consumers and companies are up to their neck in debt (see article). Even through the recession, debts have continued to grow in real terms, as people have borrowed more to sustain their spending. Not only will that limit the usual increase in borrowing that fuels an economic recovery; it also creates a risk that consumers may eventually be forced to trim their spending and save more. Companies have done more to repair their balance sheets—but not enough. Corporate debts are at record levels in relation to GDP, yet still companies continue to borrow.

America's bubble was more than just a surge in share prices. At its heart was a borrowing binge, based on the expectation that rapid growth in profits, share prices and wages would continue indefinitely. This money financed the boom in investment and consumer spending. The share-price bubble has since popped and the IT investment boom has turned to bust, yet the credit bubble remains fully inflated. Only when it deflates will the full results be felt.

The puzzle is that American consumers are in denial. Recession, what recession? In the fourth quarter of 2001 consumer spending grew at an estimated annual rate of more than 4%, partly thanks to discounting and zero-rate financing for car purchases. Many consumers seem to consider this recession as just a brief dip before a return to strong growth. But their spending habits are unsustainable.

Consumer balance sheets look horribly stretched, and some recent spending, especially on cars, is literally borrowed from the future.

Eventually, borrowers and lenders will wake up to the reality that their expectations of future growth in profits and returns were too rosy, and consumers will have to reduce their spending to bring debt back to sustainable levels. In this way, America's excessive debt burden is likely to drag down the economy, either by restraining demand for several years, or even by triggering a double-dip recession. Five of the past six full-blown recessions have included a double dip: output rose briefly as inventories turned around, but then fell again as final demand failed to follow through.

Debt, deflation and danger

Households and companies always run up debts during booms. But this time they could take longer than usual to unwind. In previous periods of excessive borrowing, inflation has quickly eroded the real debt burden. However, America's consumer prices rose by only 1.6% in the 12 months to December and inflation may well fall further.

As inflation moves closer to zero it also becomes harder to deploy monetary policy. Real interest rates in America, deflated by inflationary expectations, are still firmly positive. For the first time since the 1930s, the world's problem is not too much inflation, but perhaps too little. Massive excess capacity, the absence of corporate pricing power and rising unemployment will push inflation lower almost everywhere this year. In America a record number of companies are announcing wage freezes or pay cuts.

The good news is that Alan Greenspan, the Fed's chairman, recognises the potential risks and has cut interest rates accordingly. Most economists reckon that he has now finished the job. Yet falling inflation implies that real interest rates will rise if nominal rates are left unchanged. This is why the Fed should, once again, cut rates at its meeting next week.

The Fed has, through swift interest-rate cuts, succeeded in saving the economy from deep recession—so far. Lower interest rates reduce debt service and so allow a more gradual adjustment, but they cannot stop the pressure to reduce excess debt. That could imply several years of sub-par growth. If America escapes with a period of modest growth rather than a deep recession, that should be seen as a success. That American companies are restructuring their balance sheets far faster than Japanese companies did in the 1990s also bodes well for the future. But for many American consumers, and for investors, who have been living thoughtlessly on the never-never, the next couple of years could deliver a rude shock.

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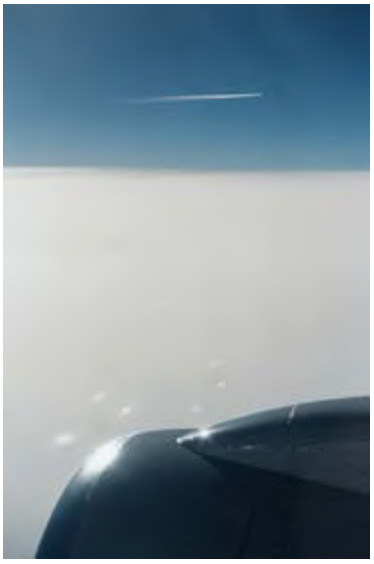
Airlines

No more squalid deals

Jan 24th 2002
From The Economist print edition

America and Europe need a genuine liberalisation of air travel



IT MIGHT seem a bad moment to attack troubled airlines. But sympathy for them may just be tipping the balance in favour of a bad deal that would reduce competition on the world's busiest route, across the Atlantic. The British and American governments are rushing through a deal that will, in effect, allow British Airways (BA) and American Airlines (AA) to merge, by pooling transatlantic flights. Since these airlines have 60% of the traffic between London and America, this looks anti-competitive, as America's Justice Department has said. Unfortunately, it is the Department of Transportation that will decide, and—like its British counterpart—it seems to be more on the side of the airlines than of their passengers.

The deal is the more undesirable because there is now a glimmer of a chance of a far bigger Europe-wide liberalisation. Next week the European Court is expected to issue a preliminary judgment stripping European Union member governments of the right to negotiate bilateral air-service agreements and handing the power instead to the European Commission, which handles other external trade issues. With this deadline looming, British and American negotiators want a bilateral “open skies” deal of their own in place, designed to serve the interests of BA and AA rather than those of travellers. Rushing to sign a treaty in the knowledge that it will be ruled illegal once the court ruling is finalised in the spring is questionable in itself. So is the motive, which—besides helping the two airlines—is partly to make it harder to negotiate a new Europe-wide deal after the court judgment.

Nine years ago America embarked on a campaign to sign open-skies deals in Europe and around the world. In themselves, they are an improvement on the regulated traffic arrangements they replaced. But as a way to get genuine liberalisation they are flawed. The template is that any American airline is allowed to fly freely to and from a country, with no regulation of fares, routes or frequencies. In return, the sole flag carrier of the small country at the other end is allowed to collude on fares and capacity with its chosen American partner, without being clobbered by antitrust law. This started with the Dutch and Germans in the mid-1990s, and has since continued with most others (France signed its deal only last week). Now only Greece, Ireland and Spain, along with Britain, have no bilateral open-skies deal.

Why not try a market?

It is wrong in principle to mix what are in essence trade negotiations with antitrust concessions to favoured carriers. Worse, these are really only half-open-skies deals, hugely tilted in America's favour. American carriers are free to fly on within Europe, but European airlines cannot pick up passengers to fly within America. Europeans can hold no more than a quarter of the voting shares in American airlines; and a “Fly America” law means that government employees or contractors must fly on American airlines—shutting off a huge slice of the market. National bilateral deals also hinder the total liberalisation of European aviation: BA, for instance, is not free to fly from Paris to America. Thus national agreements are discriminatory within the EU, one of the main reasons why the commission will win its court action.

Once the EU as a whole can sit down to negotiate with America to replace these bilateral deals, it should be able to bring more pressure to bear to force open the American market, while also further liberalising European air travel. Greeks, for instance, might prefer an airline such as bmi British Midland to fly from Athens to New York rather than ailing Olympic, which looks destined to be the third European flag carrier

to go bust. Americans, for their part, might welcome the arrival of a Virgin Atlantic offshoot to set up domestic competition in America. Domestic air travel is one of the few American markets that are still totally protected from foreign competition and starved of significant foreign capital.

There is also a tactical objection to the British-American open-skies deal. If Britain gives American carriers the greater access to London Heathrow that they crave, there will be less pressure on America to sign a truly liberal pan-European deal. Such a deal would create, in effect, a transatlantic common aviation market, opening up not just routes, frequencies and fares but also a trade in precious take-off slots, which are too often hoarded by inefficient flag carriers. The goal should then be worldwide liberalisation of this hidebound industry. A hasty bilateral British-American open-skies deal is no way to make progress towards it.

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George Bush's abortion policy

Bound to gag

Jan 24th 2002
From The Economist print edition

George Bush is entitled to oppose abortion. Interfering with family planning is another matter

Reuters

Get article background

ABORTION, most people would agree, is a horrible business. In America, it also makes for uniquely horrible politics. This week, to mark the anniversary of *Roe v Wade*, the Supreme Court case that legalised abortion in America, both sides duly threw the same tired insults at each other. Sadly, the United States seems to be exporting its conflict abroad, and in the process hurting plenty of good family-planning work that has little to do with the rights of the unborn child.

This week saw two landmarks in that process. First, George Bush hesitated over whether to authorise a $34m contribution to the United Nations Population Fund (UNFPA). Second, his executive order reinstating the "Mexico City Policy"—which stops the government providing assistance for family planning to any foreign non-governmental organisation (NGO) that is involved in abortion for reasons other than rape, incest or threat to the mother's life—completed its first year in force. Mr Bush should reconsider his position on both.

That is not just because this newspaper supports the legal right to abortion, whereas Mr Bush opposes it. The president is entitled to his opinion, and to choose how federal money under his control is spent. (So was Bill Clinton: the first thing he did on becoming president was to drop the Mexico city rule. This is the way abortion politics works in America.) But there are good pragmatic reasons for people who oppose abortion, like Mr Bush, to promote family planning and stop unwanted pregnancies in the first place.

Some opponents of abortion, notably the Catholic church, oppose contraception too. The American government wisely does not. It has allocated $450m this year to family planning overseas. Around 120m couples in the third world lack access to modern contraception, and there are around 80m unwanted pregnancies worldwide each year. Women still die in droves from the complications of childbearing or unsafe abortion. Family-planning services also address other health problems, such as sexually transmitted diseases, and indirectly help economic development.

UNFPA, the main family-planning agency, thinks poor people need $950m-worth of contraceptives this year, with another $4 billion spent on delivering them. They get nowhere near that amount. So why doesn't Mr Bush give UNFPA its $34m? Some Republicans claim the agency is supporting coercive abortion in China. There is no hard evidence to support this, which is one reason why Congress approved the money before Christmas. Mr Bush should now do the same.

As for the Mexico city rules, these seem arbitrary. Direct American financial support for abortion other than for rape and other "approved" conditions has been banned by Congress since 1973. So the aim of the "gag rule" is to control what family-planning organisations do with other people's money. And it stops them not just performing abortions, but also counselling women on the procedure or lobbying to legalise it. On the other hand, the gag rules apply only to foreign NGOs, not to governments, even if they sponsor abortion. NGOs complain that Mr Bush is forcing them to cut family-planning services in places where there are no other options.

Mr Bush is unlikely to be impressed. Family-planning groups directed similar cries of despair at his father,

and yet found ways to distribute contraceptives without promoting abortion. In his view, by failing to switch now, charities are playing feminist politics, rather than helping poor mothers. He has a point: the president is not the only one trying to export the American abortion debate.

There is precious little chance of his rescinding the Mexico rules completely. But on one particular issue, he could and should give ground. The current rules block not just American money for family planning from flowing to offending NGOs, but also donations of contraceptive devices. Surely these could be allowed for foreign NGOs, irrespective of their stance on abortion? America's abortion war has done a rich country little good; the poor world deserves it still less.

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Bloody Sunday

The truth, however unpalatable

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The Saville tribunal on Bloody Sunday may turn out to be more constructive than its detractors suggest

Popperfoto

AFTER the Nuremberg trials were over, the West German government held its own tribunals on the conduct of 85,000 Nazis. The South African government set up the Truth and Reconciliation Commission to investigate the wrongs done under apartheid. For nations, as for people, facing up to the past is part of getting over it.

Britain's record on the use and abuse of state power has been fairly good. Bloody Sunday was an exception. On January 30th 1972, 13 people were killed and 13 wounded, one fatally, in a civil-rights march in Londonderry in Northern Ireland. All, it is alleged, were shot by British soldiers. A tribunal, chaired by Lord Saville, has been sitting for four years to establish what happened. Now, with the 30th anniversary of Bloody Sunday approaching and the showing of two television films about it, Britain is facing up to this dreadful event.

The inquiry is coming in for criticism from both sides of the Irish Sea. The loudest complaints have been the length of time it has taken and the cost: about £50m and rising. Most of the money is going to that breed the public loves to hate: lawyers. But many unionists in Northern Ireland and Conservatives in Britain feel that the inquiry should never have been set up. They regard it as a sop to the Irish Republican Army (IRA) and its political wing, Sinn Fein, to get them to participate in the peace process, and see it as little more than a publicly funded vendetta against the Parachute Regiment.

Why, they ask, has Bloody Sunday been singled out for investigation? Where is the Enniskillen Inquiry, establishing who was responsible for the bomb that went off on Remembrance Day in 1987, killing 11 and wounding 63? What about Bloody Friday, when the IRA set off 21 bombs in Belfast's city centre on July 21st, 1972, killing 9 and injuring 130? In this case, as in many others, the bombers were not punished and their terrorist commanders never identified. To add to the growing sense of grievance, on January 21st two former IRA leaders, Gerry Adams and Martin McGuinness, waltzed into the Houses of Parliament after a chat with Tony Blair at Downing Street to settle into their new offices as Sinn Fein MPs.

The hostility to the Bloody Sunday Inquiry is understandable, but misguided. Not only has it already helped the peace process by meeting the single most persistent nationalist grievance arising out of the 30 years of the troubles, but it may also, surprisingly, lend some support to the unionists' account of events. Lord Saville's tribunal has already unearthed much that the republicans would have preferred to keep buried, and there will be more to come.

Although the inquiry focuses on the events of Bloody Sunday, lawyers for both the civil-rights marchers and the paratroopers have already cast the net wider to set that day in its context. Both sides have therefore had to listen to the full explanation of grievances suffered by the other side in the relative peace of the Derry Guildhall rather than on opposite sides of a barricade. Just as South Africa's Truth and Reconciliation Commission encouraged mutual understanding between two communities that had previously lived in separate worlds, so Lord Saville's tribunal might achieve the same.

Where were you, Martin McGuinness?

At the same time, the tribunal is forcing nationalists to face up to their own responsibilities for Bloody Sunday. Lawyers for the victims' families have insisted that the truth means the truth “however unpalatable”, and have asked to interview everyone, including people who were in the IRA at the time. Nationalist witnesses have been taken aback to find themselves cross-examined about the IRA, and the neat lines that were supposed to exist between civil-rights demonstrators and the IRA have been dissolving.

The tribunal has forced Mr McGuinness into admitting that he was indeed an IRA commander in Londonderry at the time. According to a much-disputed intelligence report submitted to the inquiry, he told an informer that he had “personally fired the shot from Rossville flats in the Bogside that precipitated the Bloody Sunday episodes”. All those lawyers will really start to earn their money when the likes of Mr McGuinness take the stand. In the first inquiry, conducted by Lord Widgery in the weeks after the event, only paratroopers were questioned. This will be the first time that those in the IRA at the time have faced questioning.

Bloody Sunday happened so long ago, so many key witnesses have died, so many memories have faded and so much material evidence has been lost that the full truth of what happened in Londonderry 30 years ago will never be known. But if the tribunal helps both sides in Northern Ireland's conflict to face up to their responsibilities for Bloody Sunday, then it will have been worth what it costs in lawyers' fees.

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Letters

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From The Economist print edition

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Two Blairs

SIR – Some years ago, Aaron Wildavsky, a political scientist, outlined an account of America's "two presidencies" ("The dashing Mr Blair", January 12th). Typically, American presidents have much more control over foreign than domestic policy, in part because Congress and domestic interests have much less say in foreign affairs. Under Tony Blair there seem to be "two prime ministers" constructed along similar lines.

Judging Mr Blair's record separately would give two different pictures. As a foreign-policy prime minister Mr Blair has had a great deal of success over Afghanistan and before that Kosovo. However, these successes and positive media coverage have masked domestic-policy chaos. Health care, education and transport are all deteriorating, along with a botched reform of the House of Lords and a series of domestic crises over petrol, foot-and-mouth and race.

Peacekeeping in Kosovo is probably an innately easier problem to solve than London's transport. Still, as moths to the light so politicians to favourable media coverage. We can expect Mr Blair to keep veering back towards foreign affairs in the coming years.

Shaun Bowler
Riverside, California

Keeping an "opt in" open

SIR – Now that the euro is legal tender for over 300m people, it is time to stop referring to Britain's "opt out" ("Ring in the new", January 5th). Britain has been "out" since January 1999, and seems to have prospered for it. The Maastricht protocol negotiated by John Major allows Britain to retain its own currency for ever or, at any time, adopt the euro. Provided that Britain meets the objective convergence criteria (low hurdles for a prudently managed economy) the Euroland countries have no veto similar to that used by Charles De Gaulle to block Britain's initial application to join the then EEC. We should instead be talking about Britain's permanent right to "opt in".

Richard Forsdyke
London

SIR – You write that the notion that the euro would impel closer political integration was not spelled out when euro-zone members first agreed to the idea of a single currency. That first agreement occurred at Rome in October 1990 and the European Council conclusions read: "The European Community will have a single currency which will be an expression of its unity and identity." Unity and identity spell out a political project and the euro has always been considered as such not only on the continent but also by Margaret Thatcher. Was it not precisely because she considered that the euro would impel closer political integration that she rejected the Rome conclusions? This is not, as you state, another example of "sleight-of-hand".

Philippe de Schoutheete
Brussels

On campus

SIR – As a student at Harvard who has had the opportunity to meet our new president, Larry Summers, as well as to take a class from Cornel West, I have had a unique view of the controversy that surrounds them ("Seeing crimson", January 5th). It cannot be overstated how welcome Mr Summers's active approach to the duties of his office is in an environment as steeped in tradition and reluctant to change as Harvard.

However, in the case of the Afro-American studies department, a change that would result in the loss of such academics as Mr West or Henry Louis Gates would indisputably be one for the worse. The price of maintaining the kind of intellectual capital they represent may include allowing Mr West to record a rap CD that finds little popular acclaim; the price of installing a dynamic president willing to challenge the conventions of the university may include weathering occasional overblown controversies. Both of these are prices I am willing to pay.

Robert Lindsey
Cambridge, Massachusetts

SIR – I applaud Mr Summers for his courage in taking on the entrenched interests at Harvard, in particular the Afro-American studies department. Alas, the evident problems with Mr West represent a larger, more disturbing trend among cultural-studies types at American universities: the confusion (or the refusal to distinguish) between political sentiment and worthwhile research.

Mark Vail
Paris

Blowing the whistle

SIR – Your discussion on whistleblowing is timely; there has surely never been a moment when the pressure for both employers and employees to take short cuts was greater ("In praise of whistleblowers", January 12th). The role of professional institutions and similar bodies has been greatly undervalued in this area and needs to be given more emphasis. These bodies all have a code of ethics and require their members to behave accordingly or face sanctions. They also have generally good relations with industry. They are in an ideal position to provide ethical support for members who run into problems because of whistleblowing activities and they also have a keen sense of protecting the public interest in respect of health-and-safety issues, financial malpractice, etc.

Many of the worst excesses perpetrated on whistleblowers by vengeful employers could have been avoided if third-party mediation by the relevant professional institution had been facilitated. Equally, spurious or mischievous scaremongering could be readily dispatched. A new mechanism is needed to enable institutions and employers to come together to resolve these conflicts if whistleblowing is to emerge from the dark corners of business.

Charles Turner
King's College
London

Highland low point

SIR – You remark that 18th- and 19th-century English invaders cleared Scottish peasants off vast tracts of land ("Go north, young man", January 5th). After a significant growth of population and a slump in staple exports (kelp and cattle), it was impossible for the Highlands to generate enough income to maintain its society. In addition, crops failed in the mid-19th century.

Many landowners recognised this, and took the blunt approach—clearances to make way for sheep. Others (less well publicised) bankrupted themselves before paying for their "peasants" to ship to more hopeful countries. As always, the root of this history was planted in economics. This traumatic episode led to great achievements, but also to bitter memories.

Adair Anderson
Ravensheugh, Selkirk

In the picture

SIR – English consumers wish to buy watercolours of “upturned boats in estuaries”; suppliers meet this demand (“Mired in the past?”, December 22nd). There are no obvious externalities, the market is in equilibrium and everyone is happy—except a few individuals who think they know better than the public what it should like (eg, cityscapes with ultramarine trees and blots in the sky). Where is the problem? Or is the market for watercolours somehow different from other markets?

Paul Knight
Oxford

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World economy

Dicing with debt

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From The Economist print edition

The world is awash with debt. Could this scupper today's optimistic forecasts of a strong economic recovery?

EXCESSIVE borrowing by companies, households or governments lies at the root of almost every economic crisis of the past two decades, from Mexico to Japan, and from East Asia to Russia. The past two months alone have witnessed the largest-ever foreign-debt default, in Argentina, and the biggest-ever corporate bankruptcy, of Enron. This week Kmart, America's second-biggest discount chain, filed for bankruptcy. The worst of the world recession, it is widely agreed, now seems to be over; a rebound is expected in America this year. However, the risk is that the heavy build-up of debt in many rich economies in recent years, combined with the near-absence of inflation, could hamper a sustained recovery.

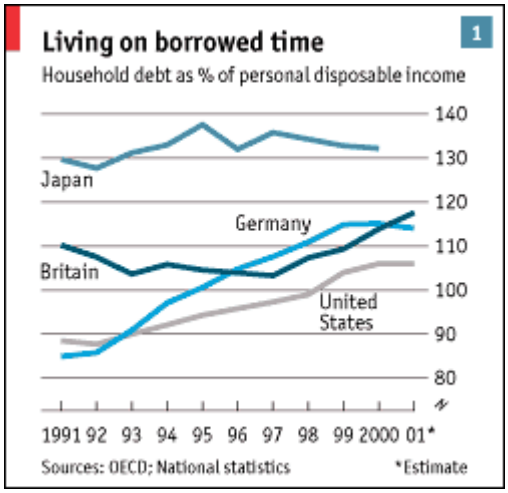
American households and companies took on record debts relative to their incomes in the 1990s—yet still they want to borrow more. Over the past year growth in new borrowing by consumers and companies has slowed, but total debt was still rising at an annual rate of 6% in real terms at the end of 2001. By contrast, in every previous recession the real level of private debt has fallen.The biggest-ever monthly increase in consumer credit occurred last November, partly thanks to zero-interest-rate loans offered by car makers. It is, indeed, largely because households have continued to borrow to finance their spending that America's recession has so far been relatively mild.

Nor is this happening only in America. In Britain, households have been on a similar borrowing binge. Their debts rose to a record 118% of personal disposable income (ie, post-tax) last year, up from 102% in 1997, fuelling a boom in both retail sales and house prices. Mortgage equity withdrawal (borrowing against rising property values to finance other spending) jumped to a record in the third quarter of 2001, reaching its highest level, as a share of income, since the end of the 1980s boom. This has helped Britain, unlike America, Japan and Germany, to avoid a recession.

American and British consumers have long been famous for their spendthrift ways. Less well-known is the fact that some continental European economies, notably Germany and the Netherlands, have also developed a big appetite for debt. Total debts of German households rose from 85% of their income in 1991 to 115% in 2000. Not only was that a bigger increase than in America; it also puts Germany ahead of America in the debtors' league (see chart 1). This may help to explain why the German economy has stumbled more than France's over the past year. French consumers have been more resilient, partly because of their more modest debts (71% of income).

Japanese households are traditionally thought of as the world's

biggest savers. But they are also the world's biggest borrowers, with debts amounting to 132% of their income. After soaring during the 1980s property bubble, that debt ratio has stayed broadly unchanged over the past decade. More worrying are the huge debts of Japanese companies, which, as they turn sour, threaten a collapse of the banking system. Equally spectacular is the Japanese government's debt of 140% of GDP, the highest in any rich country during peacetime.



Corporate debt has also surged to record levels, measured in relation to either GDP or profits, in both America and Europe. Unfortunately many companies have put some of this borrowed money to little better use than their Japanese counterparts did in the 1980s. A large chunk of American firms' borrowing in the late 1990s was used to buy back shares or to invest in what has turned out to be excess capacity. Much of the jump in European debt was linked to telecoms companies' optimistic purchases of third-generation mobile-phone licences.

Private-sector balance sheets thus look stretched in many countries round the world. But it is in America that both households and companies look most vulnerable—and hence it is there that the greatest economic risks lie. A few economists, such as Wynne Godley at the Judge Institute of Management in Cambridge, and Bill Martin, at Phillips & Drew in London, have been fretting about America's borrowing binge for several years. However, the ever cheery American consensus has insisted that there is no cause for concern.

Debtors' prism

This raises the big question about all borrowing: at what point do debt levels become dangerously high? In “Hamlet”, Polonius famously advised his son Laertes “neither a borrower nor a lender be”. But that was bad economics: a certain amount of debt is healthy, even desirable. Poor countries often have low domestic debt levels; as they develop, debt will tend to rise. It is better that surplus savings be lent to borrowers with profitable investment plans rather than lie under a mattress.

In most rich countries, private-sector debt has been rising steadily relative to GDP ever since the second world war. This partly reflects the development of a more efficient financial system that matches better the desires of savers and borrowers. Private debt has grown even more rapidly since financial deregulation, which started serously in America in the late 1970s and in Britain in the 1980s. New financial instruments, longer loan maturities and a more competitive mortgage market have made it ever easier for individuals and companies to borrow, whether to buy a home or to set up a business.

The prudent level of debt for such borrowers depends on the level of real interest rates and on expected future growth in incomes. Whether rising debt becomes a problem depends on whether profits and wages rise in line with expectations. That is the basis for the optimists' case that the level of debt in America, as well as its rate of increase, do not matter. Such optimists also point to two other arguments.

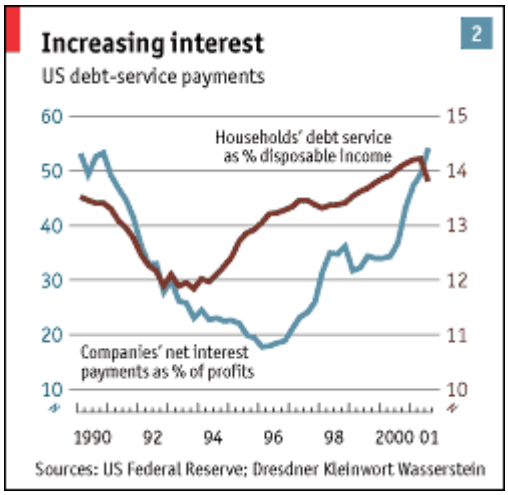
One is that the American government has recently been running a surplus and repaying public debt. This, it is claimed, has been making room for more private borrowing that had previously been crowded out by higher interest rates caused by the government's own borrowing. Today, however, the government's budget is back in deficit.

A second argument is that the rise in household debt has been more than matched by an increase in financial assets, thanks to the stockmarket and property booms in the 1990s. Despite the fall in share prices over the past two years, American households' debts are still smaller as a percentage of their assets than they were in 1990. One snag is that the assets are not necessarily owned by those who owe the debts. Another is that debt is fixed in value, but the prices of shares and property are not. If everybody tried simultaneously to realise their capital gains to repay their debt by selling shares or houses, prices would crash.

That is why the debt-service ratio, repayments of interest and principal as a percentage of income, is a better measure of sustainability. Despite low interest rates, the debt-service burden of American households now amounts to almost 14% of their incomes, higher than on the eve of the 1990-91 recession, when many debtors suddenly found themselves in trouble (see chart 2). The debt-service

payments of British households, however, are lower than they were in 1990, partly because a bigger proportion of mortgages have variable interest rates than in America.

A recent study by Dresdner Kleinwort Wasserstein concludes that America's corporate balance sheets are also in a perilous state. The ratio of short-term debt to liquid assets, and the ratio of debt to profits, are both higher than in 1990. Companies' interest payments are absorbing a record share of their profits, yet they continued to borrow more throughout last year. Their financing gap (capital spending minus cashflow) remains unusually wide compared with previous recessions, which suggests that investment has further to fall.



Much of the surge in borrowing in the late 1990s may have been based on overly optimistic forecasts for income. Last year saw the biggest fall in profits since the 1930s. Even when the economy recovers, profits are unlikely to grow at the double-digit annual rate that has come to be expected by many investors and borrowers. Over the long term, profits cannot grow faster than nominal GDP, which is unlikely to rise by more than 5-6% a year.

Household incomes will also grow more slowly than expected over the next year as unemployment continues to rise and pay is squeezed. Goldman Sachs reckons that workers' total income from employment fell in the fourth quarter; and that it will fall again in the first quarter. According to a study by the Federal Reserve, as many as 90% of American companies now offer some sort of variable compensation, such as profit-sharing, annual bonuses or share options. The bulk of such payments are typically paid out around the turn of the year. This year, they are likely to be sharply down, in line with the slump in profits. Debts that looked manageable in the good times can suddenly loom much larger in the bad.

Lost illusions

One particular concern is that borrowers may be suffering from money illusion. Interest rates in America and Britain are at their lowest for 40 years. That means that people think they can safely afford to borrow a much bigger multiple of their incomes. But it is real interest rates that matter, and in America these are still higher than they were in previous recessions. Interest rates are low because of low inflation, which, in turn, implies slower growth in the nominal wages and profits from which debts must eventually be repaid. Low inflation and interest rates may mean that debt-service payments are lower in the short term; but their burden is higher in the long term, as the real value of the debt is being eroded more slowly.

Indeed, it is precisely the low inflation that makes borrowing seem cheap that can also make it potentially more dangerous. Low inflation makes it hard or even impossible for central banks to deliver the negative real interest rates that may be needed to cushion a deep downturn (because rates cannot fall below zero). When debtors can no longer depend on inflation to erode their real debt burden, the repair of balance sheets takes longer. Japan offers a particularly scary example: deflation and shrinking nominal GDP are swelling the real burden of both private- and public-sector debt. The risk of general price deflation is low in America, but it is not negligible. Consumer prices have fallen at an annual rate of 0.7% over the past six months. On some estimates, America's nominal GDP shrank in the fourth quarter.

The combination of low inflation, money illusion and aggressive interest-rate cuts by the Fed explains why, unlike in previous downturns, the debts of American households have continued to expand briskly in real terms. Following a massive increase in debt during the boom, the Fed's interest-rate cuts are now encouraging companies and consumers to borrow even more to prop up spending. In the short term, this has made the recession shallower, but problems may still lie ahead.

Martin Barnes of the Bank Credit Analyst, a Canadian research group, says that the fact that consumer and corporate balance sheets have not been repaired has two consequences. First, this recovery will be modest, because it starts with balance sheets in a more fragile condition than usual. As a result, there is little room for the increase in borrowing that usually leads an economy out of recession. Second, there is a risk of bigger problems in the next downturn, as the pressure to restructure balance sheets may then become irresistible. Mr Barnes argues that “the Fed will try to delay this day of reckoning for as long as

possible, but that simply will make the inevitable adjustment even greater."

One of the best measures of the size of the potential adjustment that still has to be made is the private-sector financial balance (or net saving), the gap between total private-sector income and spending, a concept popularised by Mr Godley. Over the 40 years to the mid-1990s America's private-sector net saving averaged 2.5% of GDP; it remained positive virtually throughout. It then dived deeply into deficit. By 2000 net saving had slumped to an unprecedented minus 6% of GDP (see chart 3). By the third quarter of 2001, that deficit had narrowed to 2.5%, as firms slashed their spending, but it probably widened again in the fourth quarter as consumer borrowing surged. That leaves net saving way below its historical norm. If households and companies now try to push their joint net saving back into surplus, that could severely restrain investment and consumer spending.

The American economy is being propped up by consumer borrowing. If that borrowing collapses, a more prolonged downturn will follow. In rich economies heavy borrowing rarely results in a full-blown financial crisis, such as in Argentina. Instead, excessive debt acts as a drag on growth, and can amplify downturns. In the early 1990s the deepest recessions or the most protracted periods of growth below trend were in countries that had seen the biggest increase in private-sector debt in the late 1980s: Britain, Canada and Sweden. America's own recovery after 1991 was similarly hampered by an overhang of debt. The weight of Japan's debts threatens to stifle its growth for many more years to come.

New lessons for the pilot

In past decades, high inflation was the main source of economic instability, so today's conventional wisdom argues that the best contribution that central banks can make to economic and financial stability is to deliver low inflation. However, the consequences of Japan's borrowing binge in the 1980s and of America's bubble in the late 1990s—both periods of low inflation—show that price stability does not eliminate booms and busts. Indeed, low inflation combined with strong growth may even encourage the excessive optimism that underlies a credit boom.

Stephen King, chief economist at HSBC, argues that central banks' preoccupation with price stability has blinded them to the explosion of debt that went hand in hand with rising asset prices. Those excesses now have to be worked off, dragging America's growth below trend for several years. What lessons can central banks draw for the future?

In its 2001 annual report, the Bank for International Settlements (BIS), the "central bankers' bank", suggests that central banks have indeed given too little weight to the growth in debt in setting policy. Nobody is suggesting a return to credit controls, with all the economic distortions that they created. But the liberalisation of financial systems, says the BIS, has arguably increased the scope for a more pronounced financial and economic cycle. How should policymakers respond?

One idea is to try to make the financial system less procyclical. In the upturn lenders and borrowers always underestimate risk and overextend credit. Rising asset prices flatter balance sheets and so allow even more borrowing. In the downturn, lenders tighten their standards, exacerbating the slump. The BIS considers whether regulators could design built-in stabilisers by varying banks' minimum capital requirements over the cycle: raising them in booms, to restrain lending, and lowering them in recessions. In practice it would be difficult to identify the stage of the cycle, but a simultaneous explosion in credit and asset prices would be pretty hard evidence of an unsustainable boom. Ironically, the new Basel capital standards, devised by a BIS committee, may not help: when capital is varied according to the risk of loan defaults, a boom can lower capital requirements while a bust can raise them.

A second idea, suggests the BIS, is for monetary policy to respond directly to credit and asset-price booms. At present, most central banks focus only on inflation. The question is whether they should raise interest rates if credit is exploding, but inflation is low—as in America in the 1990s or Britain today. Using interest rates to correct financial imbalances is not necessarily inconsistent with the long-term goal of price stability, argues the BIS. Lifting interest rates to constrain excessive borrowing when inflation is low

may in the short run cause a small undershoot on inflation. But by avoiding future financial instability, and a deep downturn, it could avoid a much bigger undershoot in future.

The usual objection to this argument is that independent central banks have a mandate only to deliver low inflation. It would be hard for a central bank to explain convincingly why it was lifting interest rates when inflation was low. It might be criticised for undermining growth, and its independence might then be attacked.

This is not the first time that the appropriate goal of monetary policy has been challenged. In the 1960s and 1970s policy was aimed at minimising unemployment. That mistake caused inflation to take off. If governments could then shift from targeting unemployment to targeting inflation—a much more politically controversial shift—surely it is not beyond them now to explain why interest rates need to be used to curb excessive borrowing as well as excessive inflation?

Unlike the Bank of Japan, the Fed has recognised the potential economic risks as America's financial bubble has burst; it has been quick to cut interest rates. But wouldn't it have been better to have prevented the credit boom in the first place?

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Party politics

Ten Senate seats, hanging on the wall

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From The Economist print edition

In November, America goes back to the polls. The first of three pieces concludes that national issues may matter less than local ones

THIS week marks the formal start of elephant- and donkey-hunting season, otherwise known as an election year. On January 23rd, Congress reconvened with its usual stack of unfinished business. On January 29th, George Bush's state-of-the-union speech will outline the issues facing his administration (the unspoken one being: how can we defeat Democrats at the election?). His proposed budget for next year appears a week later. And the hunting season builds up to November 5th, with a grand shoot-out which could change control of the Senate, the House of Representatives and 36 governorships.

Sometimes it is possible to discern national trends in mid-term elections that benefit one party—normally the one that does not hold the White House. With the economy weak and the Congressional Budget Office confirming this week that the federal budget will be in the red this year and next, you might expect history to repeat itself in 2002. Yet if you survey the agenda in Congress, it is hard to find any pattern of partisan advantage.

First on the list is the Enron affair. This will not benefit either side unless damning evidence turns up in the course of investigations. Both parties took Enron's silver and the investigations—in ten congressional committees—will focus on the company, not the White House.

It is true that the second-round effects may benefit Democrats marginally. The affair has put campaign-finance reform back into the spotlight in the context of baleful corporate influence—a problem associated with Republicans. But campaign finance is hardly just a Republican embarrassment. Democrats get huge soft-money contributions from unions, teachers and lawyers. Perhaps more important, the issue itself animates policy wonks more than voters.

Democrats could make more hay by turning to Enron's implications for pensions. The company's hapless employees saw their pensions go up in smoke. At the same time, the weak stockmarket makes this a bad time to talk about shifting contributions from the state-run pensions system into privately-held accounts, which is what Mr Bush wants to do. His commission on Social Security has sought to downplay the matter's urgency by offering three proposals for change and recommending another year of discussion. That is unlikely to stop Democrats using the issue to alarm pensioners—a tactic they have used successfully before.

One further (non-Enron) matter could help them: health care. Democrats want a bill making prescription drugs for elderly people available through Medicare. This is wildly popular (for obvious reasons), with only one drawback: it could cost $200 billion over ten years. Given the disappearance of the budget surplus, this might seem insuperable, but there is a silver lining. Democrats can argue that there would have been enough money were it not for the president's tax cuts.

Against all that, the Republicans have advantages which could offset, even outweigh, the Democratic ones. In theory, the various anti-terrorism bills are bipartisan affairs (bills have already been passed to boost protection against bioterror; the administration now wants to double spending on “homeland security”). But they would benefit the president's party more. So, on balance, would granting Mr Bush trade-promotion authority, which he campaigned for and the House has already passed. In some districts, though, it will be a liability: steel towns are incensed that imports are undercutting local jobs.

But the most important bit of congressional business concerns the economy, especially the proposed economic-stimulus package that collapsed in the Senate at the end of last year. On the face of it, this should be the Democrats' trump card. If the economy is faring badly on election day, the “out” party

would normally win.

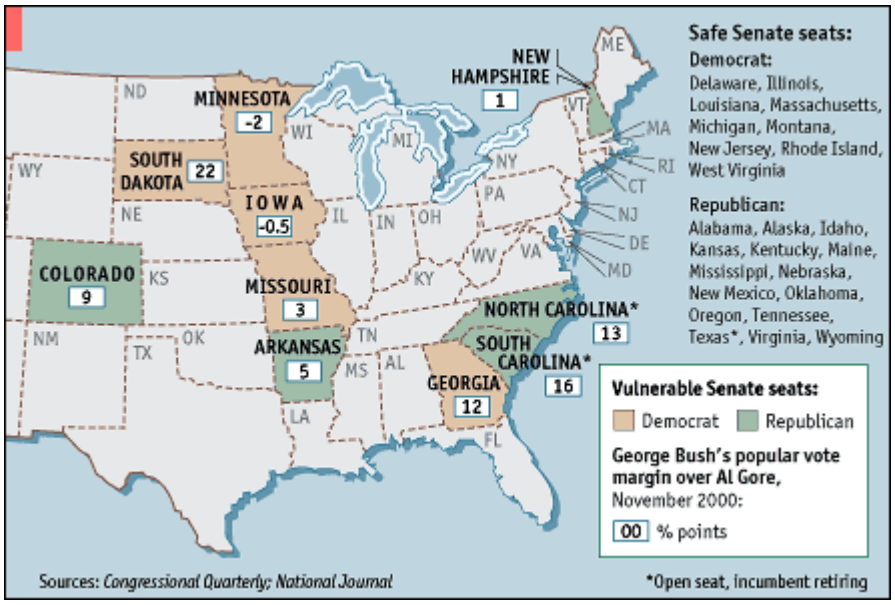
That may still happen, but the politics of the issue is complicated. Unless the downturn worsens (and the administration thinks the worst is almost over), the Republicans have a case to make almost whatever the circumstances. If the stimulus package passes, as the Senate Democrats now seem to want it to, the Republicans will claim it boosted growth. If it fails and the economy is stagnant, they will blame that on Democratic recalcitrance. And if it fails but the economy is picking up, they will claim that last year's tax cut ended the recession.

Add in the idea that the election will be fought at a time when (for once) voters are concerned about foreign matters in a way that should help the president, and you can see why the Republicans are confident. Perhaps too much so. At their annual meeting last weekend, Karl Rove, Mr Bush's chief political adviser, said that opinion polls show that voters “trust the Republican party to do a better job of protecting and strengthening America's military might and thereby protecting America”—an accurate statement but one which outraged Democrats, who claimed the other side was trying to make partisan capital out of a national war effort. Republicans will have to treat the war delicately to prevent a backlash.

Two conclusions follow. First, no big swing is likely in the mid-term elections. Control of Congress may change hands, but that is only because it is so finely poised: the Republicans are a mere nine seats ahead in the House and one seat behind in the Senate. Second, with no deciding national trends, the races will hinge on local issues and personalities.

This year, congressional seats are being fought within boundaries adjusted to take account of population shifts. Usually, redistricting produces a volatile electorate the first time around. But with two-thirds of plans finalised, the current redistricting process looks like an incumbent-protection racket. Charlie Cook, a political analyst, thinks that of the 104 House districts in California, Texas and Illinois, only three or four will be competitive—and one of those is the infamous Gary Condit's seat.

It is not quite as bad in the Senate, where redistricting does not apply. In practice, the power of incumbents is such that no more than ten, at most, of the 34 races will be close (see map). In every case, local personality will be more important than national politics. For instance:



In **New Hampshire**, the incumbent Republican, Bob Smith, briefly left the party after an ill-fated presidential run in 2000, and faces a strong primary challenge from a young congressman, John Sununu (son of the first President Bush's chief of staff). The winner will face the state's popular governor, Jean Shaheen, who is embroiled in a battle over whether to raise taxes to help failing schools.

In **Missouri**, the Democrat Jean Carnahan won her seat in extraordinary circumstances in 2000, when her husband won the race three weeks after his death in a plane crash. Her challenger, Jim Talent, narrowly lost the governorship that Mel Carnahan had earlier vacated.

In **Minnesota**, the Senate's left-wing maverick, Paul Wellstone, broke a pledge not to run again, and

faces Norm Coleman, a Democrat-turned-Republican whose centrist politics seem to suit the state well. In **Arkansas**, the Republican Tim Hutchinson is in trouble partly because his conservative voting record is to the right of the state and partly because he ran on a “family-values” ticket—then got divorced to marry an aide.

A disproportionate number of these races are in the middle of the country. In addition to Minnesota and Missouri, there are competitive races in Iowa, Colorado and—closest of all—South Dakota, a toss-up between two popular figures, the state's congressman and its junior Democratic senator. But, overall, what matters is the quality of the challenger and some personal vulnerability in the incumbent. This will make for a series of fascinating local races with national implications. But it is not a national election.

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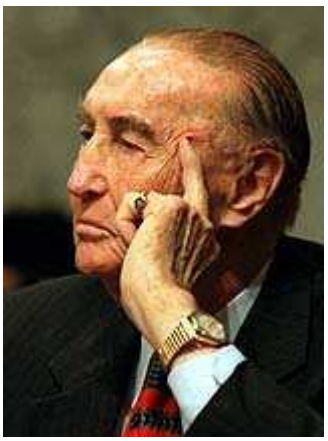
The Senate race in South Carolina

After the Strom

Jan 24th 2002 | COLUMBIA
From The Economist print edition

The Republicans look likely to retain the old curmudgeon's seat, but a maverick Democrat could still cause an upset

AP



Unrepeatable

AN OLD South Carolina quip says that the state's graveyards are jammed with politicians who had hoped to succeed Strom Thurmond. Now that the frail 99-year-old Republican is at last planning to retire, you might have expected a rush of politicians trying to fill his shoes. In fact, only two have done so.

For the Republicans, the lone candidate is a 46-year-old congressman, Lindsey Graham. A conservative lawyer from the north-western corner of the state, he is best known as one of the prosecutors at the impeachment trial of President Clinton. For the Democrats, Tom Turnipseed, a frequent campaigner, is making noises about a challenge, but the only declared taker is Alex Sanders, a former chief judge in the state court of appeals and the recently-retired president of South Carolina's oldest college. The 63-year-old Mr Sanders was the ninth Democrat asked by state party officials to throw his hat into the ring. The other eight declined, apparently fearing that Mr Graham would be a shoo-in.

It is not hard to see why they thought that. George Bush carried the state by 16 percentage points in 2000. Mr Graham, the first Republican to represent the third district of South Carolina in more than a century, won fame for his role in the Clinton impeachment. He is expected to have strong support from the Christian right and from Mr Bush (although Mr Graham supported John McCain in the 2000 presidential primary). And he has a big lead in the fund-raising stakes, with $2m in his pocket.

On the other hand, Mr Sanders is no slouch. A first-rate fund-raiser during his nine years at the College of Charleston, he has pulled in $1.1m in the short time since he filed his statement of candidacy in September. A colourful character, he has also been a poet, an environmentalist, a Harvard lecturer and a juggler of watermelons (a skill he learned in a circus as a teenager). He has an established base in the central and “low-country” parts of the state and he is popular with blacks, who make up around 30% of the state's population.

Whereas Mr Graham's politics are not hard to read—he opposed Mr Clinton more than any other South Carolina politician—Mr Sanders is something of a maverick. It is hard to measure a man who is a member of both the Sons of Confederate Veterans and the National Association for the Advancement of Coloured People. This weekend, Tom Daschle, the Democrats' leader in the Senate, is coming to Columbia to raise money for Mr Sanders—another sign that the Democrats are beginning to believe they have a chance.

To win, Mr Sanders must get around 40% of the white vote. Despite the tendency of whites to vote Republican, some Democrats, including Jim Hodges, the current governor, have broken through. Having surprisingly won the 1998 race, Mr Hodges looks likely to win re-election this year. Mr Sanders is trying to stick to the same bipartisan script as Mr Hodges; he proclaims himself a pragmatist, and quotes Fiorello LaGuardia, the former Republican mayor of New York, about “there being no Republican or Democratic way to pick up garbage”.

Mr Graham is currently the favourite—Old Strom himself has even come down to give his formal blessing. But, whoever prevails, the contest will be a nasty one. The Republicans have lambasted Mr Sanders for inadequately vetting a student adviser at the College of Charleston who was later found to be a convicted rapist. And the Democrats' state chairman, Dick Harpootlian, has come out swinging, wondering whether “the people of South Carolina really want to elect someone whose claim to fame is not being able to

convict Bill Clinton of lying under oath.”

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Florida's economy and the governor's race

Stormy weather for Jeb?

Jan 24th 2002 | MIAMI
From The Economist print edition

Gloomy times in the Sunshine State spell trouble for the president's brother

AP

WHATEVER damage is done to the Republicans in the mid-term elections, one compensation for George Bush will be that his own name will not be on the ballot paper. But his younger brother Jeb's will be. This week, the governor of Florida's "state of the state" was full of fighting talk. But few states have been more battered by the current recession. And, in Janet Reno, the former attorney general, he faces an increasingly confident challenger.

Unlike most states, Florida has no state income tax. It relies instead on its $50-billion tourism industry, and the boost that 10m visitors a year provide to the state sales tax. During the 1990s Florida saw consistent growth in tourism. September 11th put an end to that. Although the number of visitors has started to creep up again, officials say that current figures are still far below normal for their sunny ocean-lapped state at this time of year. The number of passengers arriving at Miami International Airport has fallen 26% since September. In mid-December, hotel-occupancy rates in Miami-Dade County were around 50%, almost 20 points down from the same period in 2001.

Just as serious as the lack of tourists is the falling-off in trade. According to Ken Roberts, editor of *World City Business*, which monitors local commerce, trade flowing through the Miami Customs District in September-November was $1.4 billion below the figure for the same period in 2000. Trade may drop on an annual basis for the first time since the 1980s. Air-cargo traffic has fallen sharply, and activity at the region's three deep-water seaports is also in decline, with much of the impact still to be felt (ships move slowly). The problem is made worse by the fact that South Florida's largest trade partners are in Latin America, which is having a tough time too.

Cold weather up north helped trendy Miami Beach to bounce back over the holiday season, with most hotels reporting near-capacity bookings. This year's Orange Bowl (the annual university football game) was a sell-out, with many of the 73,000 spectators coming from out of town. But hotels were offering discounts of 15-50% to lure visitors, which took a big bite out of profits. The Greater Miami Convention and Visitors' Bureau expects that the number of visitors will remain 12-15% lower than a year ago.

Signs of recession are visible throughout the state, where roughly an eighth of all jobs have something to do with tourists. In December, Florida's unemployment was 5.7%, up from 3.6% a year ago. In Orlando, scores of workers have been laid off at Walt Disney World and Universal Studios. The Breakers, a resort in Palm Beach, has sacked 150 workers, or about 6% of its workforce. And the cruise-ship industry has been laying off people too.

Worst hit is Miami, which now has the highest unemployment rate (7.5% in November) among America's big cities. Unemployment claims in Miami-Dade County jumped by 140% in October and 60% in November and December, compared to the same months in the previous year. According to the Beacon Council, the county's economic development authority, Miami could have 10% unemployment soon. It also has the worst poverty rate, 32%, among big cities.

Hurricane Janet

Florida legislators had to call two special sessions late last year to find ways to cope with a $1.3 billion

decline in state revenue. That left a significant hole in the state's $20.3 billion operating budget for the current fiscal year, ending in October. To balance the books, the governor and the two houses of the legislature, which are both Republican too, has had to postpone a $128m tax cut, and also to cut back services. The main loser was education, which suffered a brutal $591m in cuts.

Will this help the Democrats? Before September 11th, Governor Bush—a Republican of the compassionate sort, who has made real efforts with minorities and has tried a few bold moves, such as school vouchers—appeared to be almost certain of re-election. In his state-of-the-state speech, he seemed only too happy to make education the main issue, pointing to the “nothing short of amazing” results of his education reforms. He also pledged $1 billion more for education next year. And he also tried—not unreasonably—to shift some of the blame for the downturn on to Osama bin Laden.

All the same, the state's economic problems must give a chance to Ms Reno, who first made her name as a no-nonsense prosecutor in Dade County. Her party claims that the current cuts in services would have been unecessary had the Republicans been willing to roll back tax breaks for local businesses. And Governor Bush's temporary withdrawal of the tax relief is embarrasingly close to the sort of effective tax rise that his brother has promised the nation he will let the Democrats do only “over my dead body”.

Meanwhile, Republican state leaders are bickering over longer-term strategies, including a sweeping sales-tax-reform plan proposed by the Republican president of the state Senate, John McKay. Mr McKay's proposal would repeal billions of dollars in tax breaks to large business interests, including estate agents, accountants, advertising firms, broadcasters and manufacturers. Perhaps wisely, Governor Bush has yet to say where he stands on it.

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New York remembers

But how?

Jan 24th 2002 | NEW YORK
From The Economist print edition

Politics, money and the future of Ground Zero

BUILDING a fitting memorial to a tragedy is awfully hard. The Oklahoma Memorial, the only existing monument in America marking a terrorist attack, includes a controversial exhibition where visitors can listen to a simulation of the bomb explosion that killed 168 people. America's most popular memorials—the Lincoln Memorial, the USS Arizona Memorial in Pearl Harbour, and the Vietnam Memorial—were built well after the events they commemorate.

New York's first attempt to remember the twin towers collapsed on January 18th amid the sort of racial politicking people once hoped had disappeared on September 11th. The idea was for a big statue outside the fire department's headquarters in Brooklyn modeled on the famous photograph of three firemen raising the stars and stripes amid the rubble of the World Trade Centre—with one small difference: two of the (white) firemen would become a black and a Latino. Many in the 94%-white fire department objected. A new proposal is eagerly awaited.

There is also increasing pressure to come up with an idea for Ground Zero itself, not least because the clean-up there is ahead of schedule. In his farewell address, and mindful of the fact that many families will never recover the bodies of their loved ones from the ruins, the outgoing mayor, Rudy Giuliani, called for a “soaring memorial” to occupy the whole 16-acre site. But his successor, Michael Bloomberg, is making a habit of disagreeing with Mr Giuliani's positions on everything from the homeless to baseball stadiums. He quickly bowed to the reality that, for downtown's long-term viability, the site needs to mix remembrance with office space.

A selection of the architectural world's suggestions is now on display in a Chelsea show, “The New World Trade Centre”. Many confirm the public's worst prejudices about architects. One proposes two towering multi-coloured structures, each bearing changing electronic bumper-sticker nostrums such as “Save Kyoto” and “Remember Seattle”. There is a recurring interest in numerology: one plan includes a trench dug 911 feet and one inch deep, representing the 11th day of the ninth month of 2001. Slightly more promising is a suspension bridge for pedestrians extending from lower Manhattan across the Hudson. Most dramatic of all is a proposal for a temporary monument, projecting two tremendous beacons of light into the night sky above the site.

The most bitter wrangling will be over who has the right to decide what happens on the site. Larry Silverstein, a property magnate, holds the 99-year lease on the site, the right to redevelop it, and a nest-egg of insurance claims worth either $3.5 billion (if the attack counts as one insurable incident) or $7 billion (if it counts as two). He wants to begin rebuilding 7 World Trade Centre (one of the neighbouring buildings) before September 11th of this year, and he has an architect at work on the main building.

But there are other contenders. Veto power of some sort over the final design rests with the Port Authority of New York and New Jersey, which owns the land and is rather inefficiently controlled by the governors of the two states. There is also the Lower Manhattan Redevelopment Corporation, set up by New York governor George Pataki after September 11th to spearhead rebuilding. This is directed by a respected elder statesman, John Whitehead, a former boss of Goldman Sachs. It has $2 billion in federal money, and holds its first proper meeting this week.

Following the erection of viewing platforms, thousands of people are queuing for hours to look at the hole in the ground where the World Trade Centre once stood. Whatever takes its place may evolve only after much political squabbling.

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Faith-based initiatives

It's my Minneapolis

Jan 24th 2002 | MINNEAPOLIS, MINNESOTA
From The Economist print edition

A good idea v suburban selfishness. Unfortunately, no contest

AT THE Republican convention in Philadelphia in 2000, George Bush singled out the work of Mary Jo Copeland, the founder of Sharing and Caring Hands, a Catholic charity aimed at alleviating inner-city blight, as an example of "people reclaiming their community, block by block and heart by heart."

Over the past 15 years Ms Copeland has raised $40m to develop a network of widely admired inner-city social-services centres. Now she wants to move to the suburbs of Minneapolis and St Paul to build a $30m orphanage-cum-school for some 200 children. Few doubt her ability to get the money. The problem is finding a suburb that will let her in.

Since Ms Copeland (once dubbed "the Mother Theresa of Minnesota" at a national prayer breakfast) announced her plan in December 2000, the proposed Gift of Mary Children's Home has been rejected by three suburban city councils, all citing local ordinances and zoning laws. A fourth, in Chaska, will vote on January 28th, but plenty of Chaskans turned up to object at a planning meeting last month.

The protesters insist that orphanages are a bad thing, and point out that children generally fare better in foster and adoptive homes. Ms Copeland responds that her orphanage is intended for children who have done poorly in foster and adoptive homes (often large groups of brothers and sisters). Such children, she adds, also tend to get left in their original, often abusive homes by the state. The Minnesota Department of Human Services admits that only 7.5% of children in unsafe homes are removed from them for any length of time.

There is perhaps a less altruistic motivation behind the protests, too, one that has to do with suburbanites alarmed at the prospect of 200-odd poor kids moving in just around the corner. What, they wonder, will happen to house prices, crime rates, school districts and local tax revenue (as a non-profit project, Ms Copeland's orphanage would be tax-exempt)?

Meanwhile, the chances of Mr Bush's controversial White House Office of Faith-Based and Community Initiatives helping Ms Copeland are slim. The agency's director, John DiIulio, quit in a huff last year, and the legislation which would provide money for faith-based schemes has been stuck in the Senate since July.

Ms Copeland's difficulties are a good example of the problems that faith-based initiatives, even successful ones, face at the local level. Last January Ms Copeland appealed to the city council of Brooklyn Park, a suburb of north-east Minneapolis, by saying that God wanted her orphanage to be there. God's will is apparently no match for Minnesota's zoning laws.

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Native Hawaiian culture

Do gods need telescopes?

Jan 24th 2002 | KONA, HAWAII
From The Economist print edition

Rumblings are coming from the top of one of Hawaii's old volcanoes

THE summit of Mauna Kea, almost 14,000 feet high, is a stark red landscape dotted with the peaks of cinder-cones, or *pu'u*, reminders of the area's violent volcanic past. Today the *pu'u* are causing a different kind of turmoil, between native Hawaiians who say this is sacred land and astronomers who have built telescopes all over it.

Until 1968 the summit was as desolate as Mars, apart from a few stone shrines to the gods and goddesses believed to live around the *pu'u*. Today 13 astronomical observatories and satellite stations, together worth more than $1 billion, sit inside a 12,000-acre science reserve, which is leased to the University of Hawaii.

For native Hawaiians, the summit is the most sacred area on their islands. For astronomers, the dry, dark skies up there are—so far as earth-based astronomy goes—as close as you can get to heaven. On Mauna Kea scientists have discovered planets orbiting stars outside the solar system, and have proved that the rate of the expansion of the universe is accelerating.

When plans were drawn up for a new development in 1998, the university was criticised. The land, which belonged to Hawaii's queen before the Americans deposed her in 1893, is considered by native Hawaiians to be merely “ceded” to the United States. Rumours still persist that ancient bundles of bones were uncovered (and then mysteriously disappeared) during the construction of several telescopes.

In their defence, the scientists can point to plenty of locals who think that the telescopes bring prestige and prosperity to an island in urgent need of jobs. And hardly anybody blames the astronomers for building there in the first place. In the late 1960s there was little awareness of native culture, which was suppressed after the overthrow of the monarchy.

Signs have been put up explaining the cultural importance of the area, and a defunct astronomical test site, the home of the snow goddess Poli'ahu, is being restored to its natural state. Some locals want the telescopes taken down at once; others want development stopped; still others want it better run. Astronomers, though overtly sympathetic to cultural arguments, ultimately just want to go on building bigger and better toys on the summit.

The university's lease lasts until 2033. But telescopes, such as the proposed Next Generation Large Telescope, are designed over decades. With Native Hawaiians expecting, at the very least, far more consultation over the future use of the summit, the chances of astronomers planning big new observatories on Mauna Kea are receding into those dark, dry skies.

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Ageing terrorists

The fascist insect bites back

Jan 24th 2002 | SAN FRANCISCO
From The Economist print edition

Rounding up the radicals who plagued California during the 1970s

AP

The end for Olson

GHOSTS of counter-culture radicalism haunt San Francisco. Superannuated hippies mingle with the tourists at Haight-Ashbury. Other, more sinister, mementoes of the era occasionally turn up. Long-forgotten caches of dynamite and guns, for instance—the leftovers of the Symbionese Liberation Army (SLA), a crackpot band of revolutionaries who rallied to the snappy slogan: “Death to the fascist insect that preys upon the life of the people”.

During its brief existence in the mid-1970s, SLA safe houses dotted California. A quarter of a century later, the state is performing an exorcism. On January 18th a Los Angeles court handed down a sentence of 20-years-to-life for Sara Jane Olson, a former SLA member, for taking part in a plot to blow up a police car in 1975. Ms Olson has also been accused of participation in an SLA bank robbery in Carmichael, near Sacramento, during which a woman was killed. She will stand trial for murder later this year, along with four other alleged SLA members.

The SLA's first public act, in 1973, was the murder of a school administrator in Oakland. The group gained wider notoriety when, in 1974, it kidnapped Patricia Hearst, a 19-year-old heiress to a newspaper fortune. In a bizarre turn of events, Ms Hearst was converted to the SLA's cause and filmed toting a sub-machine-gun and participating cheerfully in a bank heist. Ms Hearst was subsequently sentenced to seven years for armed robbery.

Ms Olson managed to avoid the law until 1999, when she was arrested in Minnesota. Like several of her fellow revolutionaries, she went into hiding when the SLA disintegrated after a bloody shootout with Los Angeles police. She built a new life for herself, with a new name and identity (she was born Kathleen Soliah, the name she used during her SLA days). At her trial, her husband, daughter and pastor, among others, testified to her peaceful nature.

On January 22nd, Ms Hearst popped up on CNN to profess her willingness to testify against her confederates in the next trial. “It was their own little jihad they had going,” she said. Ms Hearst's own sentence was commuted after 22 months by Jimmy Carter, and she was formally pardoned by Bill Clinton. Ms Olson now has plenty of time to ponder the justness of all that in her prison cell. She might even catch her erstwhile comrade in the cult movie, “Cecil B. Demented”, in which Ms Hearst plays the mother of a terrorist film maker who kidnaps an ageing movie star and forces her to appear in his film.

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Lexington

The prisoners dilemma

Jan 24th 2002
From The Economist print edition

Neither Europe nor America emerges well from the row about Guantanamo Bay

NOT since the Boston Tea Party has a consignment to the new world produced such differing reactions on either side of the Atlantic. Last weekend, the Pentagon released pictures of prisoners arriving at Camp X-Ray in Cuba. In Britain, the *Mail on Sunday*, a conservative paper, usually slavishly loyal to America, devoted its entire front page to a picture of the masked and shackled prisoners, with the headline “TORTURED”. By contrast, the *New York Times*, a paper normally quick to point out incivility in George Bush's administration, buried the story on an inside page under the cuddly headline “For America's captives, home is a camp in Cuba, with goggles and a Koran”.

The dispute about Camp X-Ray is becoming a more damaging re-run of the earlier rift with Europe over the Kyoto protocol on global warming. On the European (especially British) side, exaggerated criticism has taken the place of reasonable doubt. On the American side, the arrogant dismissal of legitimate concerns could be stirring up unnecessary problems abroad.

So far, the accusation of torture is, to put it mildly, unsubstantiated. The photographs themselves show prisoners in transit, where restraints are legal under any number of international conventions. They do not depict the conditions of detention. The weaker charge—laid by many European governments and the European Commission—is that keeping prisoners outside, shaved, and in cages amounts to inhuman treatment. It too seems bogus. The Red Cross is still investigating, but a British captive told diplomats that the conditions were acceptable. Unless Cuba's balmy weather is intolerable to fighters who have spent the winter in Afghan caves, the charges don't stand up.

The mistake is revealing. In Britain the furore about Camp X-Ray has spread well beyond the reliably Yankophobic redoubts of the left. Conservative MPs and veterans of Nazi POW camps also expressed their disgust. Yet an unscientific instant poll on the Internet version of one tabloid found a large majority refusing to condemn Camp X-Ray as barbaric. That suggests the European reaction may have more to do with anti-Americanism among the elite than any deep-felt public revulsion.

Still, it carries a cost. European grumbles have reconfirmed a suspicion in America that the old world is a continent so hopeless that America must regularly ride in to rescue it from war. Such views, expressed on talk-shows in the heartland, also find an audience in the Bush administration. His people are anyway sceptical about international treaties and waffle (see foreign policy, passim). The Camp X-Ray episode

could make them still more dubious about assuaging foreign opinion. Donald Rumsfeld's remark that he “didn't feel the slightest concern” about the prisoners could also apply to his feelings about foreign criticism.

Which is awkward, because alongside unfounded accusations of torture, lies a second, more reasonable criticism: that the prisoners are not being accorded proper legal status. The Pentagon says they are “unlawful combatants”, but there is no such category in international law. Detainees are either ordinary criminals and should be charged as such, or prisoners-of-war, protected by the Geneva conventions. There is no third way.

With the al-Qaeda prisoners, the Pentagon has a case, though it is not making it particularly well. The attacks on New York and Washington were acts of war by any normal definition. So was the conflict in Afghanistan (the congressional resolution that preceded it was, in effect, a declaration of war). The al-Qaeda detainees are not ordinary criminals. But neither are they ordinary prisoners-of-war. International law gives POWs special protection on the grounds that the responsibility for soldiers' actions rests with the state they are fighting for. Al-Qaeda is not a state. Many in Guantanamo Bay are not Afghans, so if they are prisoners-of-war, which state was responsible for their actions: Pakistan? Britain? Of course not. In the next week or so, the Pentagon will start trying to distinguish between different categories of al-Qaeda prisoner. Some may be extradited to their own countries for trial. A few may be released. Many will be tried by military tribunal or federal courts. At that point, America's attitude to international law will be clearer. Until then, some of the European doubts are premature.

But the same would not apply to any Taliban fighters in Guantanamo Bay. Unlike their al-Qaeda comrades, they surely deserve POW status. They were fighting for their government (however hideous) against a foreign power in their own country. If they committed crimes against civilians, that is different. But they should not be charged with fighting as soldiers.

Who is the fairest of us all?

Worse, America is vulnerable to charges of double-dealing. It may have reasons for not invoking the Geneva conventions. But it has not shown the care for legal proprieties that it did in another case of an accused terrorist: that of Lori Berenson, who in 1996 was found guilty by a military court in Peru of belonging to a terrorist group. On that occasion, the State Department complained that her trial was “without sufficient guarantee of due process”, adding that “proceedings in these military courts and those for terrorism in civilian courts do not meet internationally accepted standards of openness, fairness and due process.”

Ms Berenson, of course, is American. And that in turn should remind the administration of why it needs to take account of foreign opinion, however outrageous it might seem. America is an exemplar for others and its success in the war against terror will be determined partly by the way in which its actions are seen and interpreted in the rest of the world. Naturally, dodgy regimes will use American decisions as excuses for their own malpractice. But members of the administration should at least not be encouraging this by their own insouciance. And—still more important—European leaders should not be gratuitously inflaming world opinion by monstrous distortions.

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Violence in Brazil

Kidnapping an election agenda

Jan 24th 2002 | SAO PAULO
From The Economist print edition

AP

The killing of an opposition leader poses some ugly new questions for this year's presidential campaign

Get article background

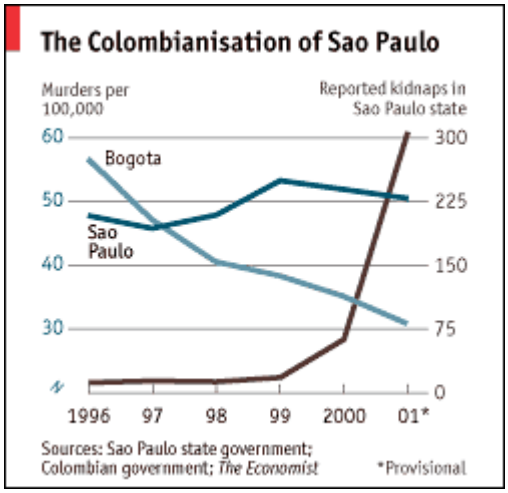
IS THERE a campaign to exterminate senior figures from Brazil's main opposition, the left-wing Workers' Party (PT)? That was what some of the party's leaders feared this week, after the kidnap and murder of Celso Daniel, the mayor of Santo Andre in Sao Paulo's industrial belt. Mr Daniel was also in charge of drawing up the party's manifesto for October's presidential election. Only four months ago, the PT mayor of Campinas, the second-largest city in Sao Paulo state, was shot dead. A previously unknown group, the Brazilian Revolutionary Action Front, claimed responsibility, and said it would kill others it blamed for the Workers' Party's move to the political centre. Other party figures have also reported being shot at or receiving death threats.

Assassinations of public figures for clearly political reasons (as opposed to personal rows) are rare in Brazil, though intimidation by false death threats and bomb hoaxes is not unusual. And though the PT's presidential candidate, Luiz Inacio Lula da Silva, leads the early opinion polls, so he has before losing each of the past three elections. Both mayors were attacked while travelling by car at night. It seems more likely that they may have been among the many victims of Sao Paulo's recent epidemic of kidnaps. Some criminal gangs have switched from bank raids, to specialise in kidnapping and car-jacking.

Whoever killed Mr Daniel, a leading PT moderate, his death has provoked outrage. It follows a recent spate of audacious criminal stunts, including landing a hijacked helicopter in a prison yard to spring two gangsters. These events highlight the increasing insecurity of everyday life in Brazil: Sao Paulo is now a more violent city than Bogota, Colombia's capital (see chart). And they expose the failure of government at all levels to tackle the problem.

This week, President Fernando Henrique Cardoso and Geraldo Alckmin, Sao Paulo's governor, promised urgent measures to wage “war on organised crime”. Not again, sighed critics: few of the proposals announced this week are new. Many of them, such as the creation of new top-security federal prisons and recruiting more police, were in a public-security plan that Mr Cardoso launched with great fanfare 19 months ago. Other long-awaited crime-fighting measures, such as a gun-control bill and reforms of the cumbersome and corruption-prone justice system, remain stuck in Congress, blocked by vested interests.

Brazil's police forces, too, require thorough reform. But so fierce is the resistance of police chiefs to the mere idea, that the federal government, and many state governors, have backed away from even proposing it. Each of Brazil's states have two forces: the "civil" police, nominally a detective force, and the "military" police, a uniformed constabulary. Rivals rather than colleagues, they seldom co-operate.



In Sao Paulo, Brazil's most important state, recent rises in spending lavished on the police seem simply to have been soaked up by their bureaucracy. Merging the forces and slashing their hierarchy could free 300m reais ($126m) a year to spend on better training and detection resources, says Jose Vicente da Silva, a former police chief now at the Fernand Braudel Institute, a Sao Paulo think-tank. Besides being inefficient, the two forces are corrupt. A kidnapping gang in Campinas was recently found to include civil police, while military police were caught selling drugs in Sao Paulo city centre. Police chiefs dismiss such cases as exceptional; in fact, they have become the norm.

Mr Alckmin, who is from Mr Cardoso's Brazilian Social Democratic Party (PSDB), says that 490 bent policemen were kicked out last year, more than ever before. Like his counterpart in Rio de Janeiro, he is trying to merge the two forces in practice, if not in name. For the first time, their commanders have been persuaded to share a headquarters, and intelligence-gathering is being pooled. Mr Alckmin also promises to recruit thousands of clerks to free policemen from paperwork.

But all this may be too little, too late, to secure his return as governor in October's vote. Mr Alckmin's difficulties could undermine the presidential prospects of Jose Serra, the PSDB candidate, who is a senator from Sao Paulo as well as being Mr Cardoso's former health minister. To his right, Mr Alckmin is vulnerable to Paulo Maluf, a populist former governor who backs the death penalty and repressive policing. To his left, he now faces a stronger challenge from the Workers' Party. It has traditionally blamed crime on poverty, taking a liberal line on policing and punishment. But this has contributed to its defeat in the past three national elections, denying it support among poor Brazilians, who suffer most from crime (despite the greater media coverage given to its wealthier victims).

Spurred by the loss of two of its leaders, the Workers' Party's new crime policies, to be announced shortly, are expected to promise "zero tolerance" and radical police reform. Its candidate for governor in Sao Paulo, Jose Genoino (who fought as a guerrilla against Brazil's military dictatorship but is now a leading party "moderniser"), wants life sentences for kidnappers. Mr Cardoso's PSDB, at state and federal level, has failed on law and order. In Sao Paulo state, and perhaps in Brazil as a whole, the Workers' Party may now calculate that being "tough on crime, tough on the causes of crime" could bring the same successful political outcome as it did for Tony Blair's New Labour in Britain.

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Cuba and the United States

The best of enemies

Jan 24th 2002 | HAVANA
From The Economist print edition

Fidel Castro is being helpful over those prisoners at Guantanamo

AP

Get article background

WHEN the United States began transporting Taliban and al-Qaeda prisoners to the naval base at Guantanamo Bay, a 117 sq km (45 square mile) enclave on the Cuban mainland, this might have been expected to prompt an outburst of anti-imperialist rhetoric from Fidel Castro, the island's Communist president. After all, Guantanamo is a provocative quirk of history, occupied (and leased for the nominal sum of $4,085 per year) by the United States ever since an expeditionary force landed there in 1898 to expel Spain from Cuba. Mr Castro has long demanded its return.

But Cuba's government is being unusually conciliatory over Guantanamo's use as a prison camp. While reiterating its claim to the base, it said that "mutual respect" now prevails between Cuba and the United States, and offered medical and sanitary help. Raul Castro, the defence minister and the president's brother, later added that in the event that any prisoners escaped (unlikely, it would seem), they would be captured and handed back.

This helpfulness is a further sign of a modest warming in relations. In November, Cuba bought some $30m in food from American companies, in the first trade deal since the United States imposed its embargo against the island in 1960. However, both sides stressed that this was a humanitarian measure, after a hurricane had hit Cuba.

What explains the new tone? Foreign diplomats speculate that Cuba, facing great economic difficulties, has the desire, and may have an opportunity, to improve relations. The island's economy is reeling, not just from the hurricane but from a drop in tourism revenue. Cuba wants to be removed from America's list of countries that support terrorism; Mr Castro gave up trying to "export revolution" to Latin America and Africa a decade ago. The goverment was quick to condemn the September 11th terrorist attacks. It has been at pains to suggest that, although it does not agree wholly with the way that the United States is conducting its war against terrorism, it supports the principle of that war.

This stance has brought some plaudits. "At this time, our countries should be working together," said Senator Maria Cantwell, a liberal Democrat who recently dined with Mr Castro. In the United States, centrist opinion is moving slowly towards easing the embargo. George Bush is not of that view, however. Cuba and the United States will not become friends overnight. But Mr Castro is clearly not the most threatening enemy the United States now faces. After 40 years, the ice across the Florida Straits is starting to thaw.

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Argentina's crisis

Harsh realities

Jan 24th 2002 | BUENOS AIRES
From The Economist print edition

In economics, as in foreign affairs, the Duhalde government has little leeway

Get article background

GUIDO DI TELLA, Argentina's foreign minister for much of the 1990s, once declared that his country wanted “carnal relations” with the United States, from which it had been estranged for half a century. But rightly or wrongly, many Argentines blame their country's economic collapse at least in part on free-market policies which they see as championed by America. When Carlos Ruckauf, the foreign minister in President Eduardo Duhalde's new government, took up his job this month, he said pointedly that “in foreign affairs, I am polygamous”. Should the United States feel scorned?

AP

From ally to scapegoat

Certainly, Mr Duhalde would like to diversify Argentina's foreign ties, and in particular to revive those with Brazil, its chief partner in Mercosur. Brazil has quickly responded: as well as lobbying for international help for Argentina, it has promised to take more imports, especially of cars. With drug supplies in Argentina disrupted, Brazil has donated insulin to save the country's diabetics.

But the stark truth is that now, more than ever, Argentina needs help from the IMF, and therefore the United States. As a State Department official is alleged (by a local press report) to have told an Argentine diplomat: “who's going to put up the money for your economic plan? Brazil?” True or not, Mr Duhalde has grasped the point. Last week, he spoke to George Bush on the telephone, and was told to come up with a “coherent” economic plan.

Above all, that means tackling the ghastly problems of Argentina's banks, which have become the target of increasingly violent protests. Mr Duhalde inherited draconian restrictions on bank transactions and withdrawals, which halted a bank run but are strangling the economy. But his government's handling of this month's devaluation of the peso, and its adoption of a dual exchange rate (temporarily, it says), have added new snags.

The crux of the problem is that two-thirds of bank deposits are in dollars, as are most loans. To the fury of the bankers, Mr Duhalde promised that dollar deposits would eventually be honoured in dollars, while ordering that bank loans of less than $100,000 be converted into (devalued) pesos. The government estimates the cost of this mismatch at $5 billion; it has proposed compensating the banks by taxing oil exporters. But other estimates put the total damage to the banks (including likely loan defaults) at up to ten times as much as the official estimate. Most of the large banks are foreign, and their owners are publicly threatening to walk away from Argentina.

Mr Duhalde's measures were aimed at cushioning the impact of devaluation on the hard-pressed public, who have already suffered recession since 1998. But as Carlos Escude, a foreign-policy specialist, says, the measures have aroused “an invincible coalition of opponents”, including European governments as well as the IMF and the banks, and foreign-owned utility companies (whose tariffs, rightly, are being switched to pesos).

Under this pressure, Mr Duhalde has backed away from his first big promise. Officials now say that dollar deposits will be converted to pesos, though probably indexed to inflation. This week, they eased the bank controls slightly: those with dollar bank accounts can withdraw up to $5,000, but in pesos and at the official exchange rate of 1.40 pesos to the dollar. In the free market, the dollar is worth 1.80 or more.

The government also hopes to boost its credibility abroad by setting up an international team of policy advisers. One proposal from two American economists, Adam Lerrick and Allan Meltzer, is to allow the banks to issue negotiable deposit receipts, which could be used as cash.

None of this, however, has dampened the ardour of the government's romance with Brazil (whose central-bank chief, Arminio Fraga, is also on the advisory panel). Now that Argentina has abandoned its fixed currency, officials from both countries are enthusing about the possibilities for reviving Mercosur, and maybe even for a common currency. But that is a long way off. First, Mr Duhalde has to cut a deal with those who might give him some money.

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Ecuador's economy

Mixed blessings

Jan 24th 2002 | QUITO
From The Economist print edition

Can dollarised Ecuador avoid the Argentine trap?

TWO years ago, Ecuador was a mess. It had defaulted on its public debt, many of its banks had collapsed, hyperinflation beckoned and the president was overthrown. Out of desperation, the new government adopted the dollar as the country's currency. So swiftly has Ecuador since recovered that, citing its example, some economists recommend the dollar as a cure for Argentina's troubles. But many Ecuadoreans are now having second thoughts about dollarisation.

First, though, the good news. Last year, Ecuador's economy grew by 5.4%, the fastest rate in Latin America, the budget was balanced, and inflation was 22%, down from 91% in 2000. Another sign of stability is that, for the first time in 15 years, Ecuador, an Andean nation of 13m, completed an IMF loan programme. And thanks to foreign investment in the oil industry, the economy is forecast to grow by 4.2% this year, against 1.4% for the region as a whole, according to the Economist Intelligence Unit, our sister company.

Welcome though it is, this economic growth is simply making up ground lost in the 1998-9 collapse. It owes much to high oil prices, and remittances from migrants working abroad. In the past three years, some 400,000 Ecuadoreans have left, mainly for Spain and the United States, according to government estimates. Remittances totalled $1.4 billion last year, the second-largest source of foreign exchange after oil.

Back home, many citizens have still not felt much benefit from recovery. Real wages are declining. According to government estimates, 56% of Ecuadoreans are poor, meaning that they earn less than $42 per month. In urban areas, only four in ten workers have a proper job. Protests against rises in the price of fuel this month ended with one person killed. A recent opinion poll in the two main cities, Quito and Guayaquil, found that 50% of respondents favoured going back to the ill-fated sucre, the former currency.

In addition, some Ecuadoreans worry that their country risks running into the same kind of trap that Argentina faced when it pegged its currency to the dollar. The first worry is the rickety public finances. Debt service on past loans eats up half of the government budget, despite the 1998 default. And government revenues remain dependent on volatile oil prices (oil income accounted for a third of the country's total income last year). This year, lower oil prices, plus the need to repay $400m in loans falling due, mean that the government faces a shortfall of around $1 billion. With an election due in October, it will find it hard to raise taxes, or cut spending. Already, officials are talking about delaying the planned end of a blanket subsidy on cooking gas (costing $150m a year), because of their inability to set up a targeted system for helping the poor. So the government may pile up more debt, and with it, future headaches.

The second problem concerns competitiveness. Already, exporters are feeling the pinch, as inflation drives up their costs (see chart). In the eleven months to November, non-oil exports were down 3.7% on the same period in 2000. Imports are soaring, partly to supply the recovering economy, but partly because food and consumer goods from Peru and Colombia now beat local products on price as well as quality.

Ecuador's economy is relatively open: its foreign trade in goods was equal to 55% of its GDP last year, while the equivalent figure for Argentina was 18%. And 38% of Ecuador's exports go to the United States, compared with 12% of Argentina's. All of that makes the dollar a better bet as a currency in Ecuador than in

Argentina.

But making the most of openness requires flexibility (in prices, wages and labour markets) in response to outside events. Ecuador has some time to adjust. Thanks to a new oil pipeline, oil exports (and government income) should rise sharply from next year. But in the medium-term, the dollar will bring prosperity only if political leaders draw the right conclusions, and try to turn their country into an Andean version of Hong Kong.

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Afghanistan

A credit line for peace?

Jan 24th 2002 | TOKYO
From The Economist print edition

Reuters

Hamid Karzai got more than he might have hoped from the donors in Tokyo. Can he use it to hold Afghanistan together?

Get article background

THE aid offers were not ungenerous—about $4.5 billion, of which $1.8 billion should be handed over within a year—the atmosphere was cordial, and Hamid Karzai, Afghanistan's interim leader, cut an impressive figure in his green and purple robe. But Chris Patten, the European Union's external-relations commissioner, played the party-pooper, reminding an international meeting in Tokyo on aid to Afghanistan that “donors' conferences and swell hotels and thick carpets” were much less important than what happens on the ground of that benighted land.

So what is happening, five weeks after Mr Karzai's fragile but internationally-supported administration took up the reins of office, with a brief to lift Afghanistan out of two decades of war and misery? A mixture of good and bad things, some of them closely related to the goings-on in Tokyo's padded luxury.

In a secretive, high-security operation, the United Nations Development Programme has delivered $6m, in cash, to the Afghan central bank. As a result, the country's civil servants got their first payment for seven months, about $50 each.

In Japan, meanwhile, the American secretary of state, Colin Powell, invited Mr Karzai and some of his government colleagues to provide specimen signatures—so that their government could tap into the country's frozen financial assets and benefit from Afghanistan's readmission to the world economy.

International aid money will be the Karzai government's main hope of asserting some authority over a perennially fissiparous state, where half a dozen ethnic groups and factions may have united, with American help, to overthrow the Taliban, but still have little love for one another. Already, there are reports of skirmishing in the northern province of Kunduz between Uzbeks loyal to the local chieftain, Abdul Rashim Dostum, and his ethnic Tajik rivals. If the Tajiks involved are under the influence of warlords with a stake in the Karzai

government, then the fighting may die down. But if they are taking orders from ex-President Burhanuddin Rabbani, who has been left out of the new adminstration, the problem could be more serious. In western Afghanistan (see article), there are already signs of resurgent Iranian influence. In the south, Mr Karzai needs to control rivalries among his fellow Pushtuns. His best hope of keeping a grip on the country lies in parcelling out enough aid money to keep regional power-brokers loyal—whilst being careful not to lose control of the purse strings.

Among the donors, too, there are conflicting agendas—and frantic attempts to bring them into line. James Wolfensohn, the president of the World Bank, has been imploring governments to put as much as possible of their offerings into a common fund, to be overseen by his agency, as well as the UNDP and the Asian Development Bank. But many donor governments have “pet projects” over which they are keen to retain control. Japan, for example, wants to get its name on projects to remove landmines. Many western governments want a direct link with education projects, especially those which benefit women.

For America and several other countries, a top priority is finding a way to prevent a fresh flood of Afghan heroin from cascading on to the world market—though it may be too late to stop farmers gathering in the opium poppy crop which they sowed last autumn, just as the bombs began falling. The harvest is due to begin in March.

Poppy politics

How exactly to disrupt the opium trade is a puzzle which the UN drug agency in Vienna has yet to solve. Simply buying up the crop is a tempting option, but it would be resented by farmers who grew other things. The most promising may be a crop eradication programme, combined with imaginative forms of compensation for farmers who switch to other products. It will help if the reconstruction of roads and buildings is under way by March—so that job-seekers have some alternative to working in the opium harvest.

In the war against drugs, and in every other form of assistance to Afganistan, aid agencies will often face the challenge of appealing to the interests of ordinary Afghans, over the heads of local power-brokers. Although Mr Karzai has followed the Taliban in declaring a ban on the cultivation of opium poppies, it seems far from clear whether the new government has the power to enforce this. In recent years, control of the drug trade has emerged as the biggest token of wealth and power—and those who have enjoyed such control will not give it up lightly.

For all the differences, UN officials say there are lessons from other war zones that must be applied in Afghanistan. Aid agencies can often distort local economies by driving up rents—as expatriates snap up the best properties—and hiring away talented people who would otherwise be working for local governments. Urban populations can swell out of control, with aid money a magnet. Worse, carelessly applied assistance can simply shore up the power of local warlords—and drug barons.

Mark Malloch Brown, the UNDP's director, cites the recovery of Mozambique as a success story which Afghanistan might want to emulate. Perhaps so; but in Mozambique's neighbourhood, there was one regional super-power—South Africa—whose role as big economic brother was unchallenged. Afghanistan has several medium-sized neighbours with an interest in, and influence over, its fate—Pakistan, Iran and Russia, for a start—and it is still not clear whether they have broken the bad old habit of using the Afghans as a proxy for their own interests.

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Afghanistan and Iran

If you want a Mercedes, try Herat

Jan 24th 2002 | HERAT
From The Economist print edition

One Afghan city, at least, is booming—and backing the central government

IN THE far north-west, Herat is visibly the most prosperous town of Afghanistan. The electricity cuts are as frequent as in Kabul, but the packed customs yards full of container trucks, the fancy clothes and goods bazaars, and the fact that many people have a working telephone, are signs of how well it functions compared to other parts of the country.

All this is largely thanks to Herat's neighbor, Iran, which has kept its border open over the years, taking in up to 2.5 million Afghan refugees and allowing a busy cross-border trade even under the Taliban. Herat has become the main legal entry point for foreign goods not only from Iran, but China, Japan and Dubai, and business is good. “If you want to buy a Mercedes, fuel or a can of coca cola, you need Herat,” says one foreign resident of the town.

The best buys here are soft Iranian blankets, cheap factory-made carpets, Ashi-Mashi, the Iranian cola drink which is served everywhere, and all manner of household goods from plastic crockery to stainless steel teapots. Aman Nawabi, 27, sells almost exclusively Iranian household goods in his Herat shop, and ships two trucks of goods every month to other cities in Afghanistan, including the capital.

Humanitarian aid is also arriving with an ease that is the envy of the northern provinces around Mazar-i-Sharif, blocked by the bureaucracy and closed attitudes of the former Soviet Central Asian countries.

The man who benefits the most from all this is Ismail Khan, the famed resistance leader and former governor of Herat who has reclaimed his old place at the governor's house. He holds sway over five provinces, and with it the lucrative customs and trade routes. He has not yet paid any dues to Kabul, he said in a recent interview. “If the government wants it, we are ready to pay, but the head of the government, Hamid Karzai, has not asked for anything yet,” he said.

Ismail Khan is one of the regional warlords causing concern among American and UN officials, who are anxious to strengthen the one-month old interim government in Kabul. When he was last in power during the mujahideen government from 1992 to 1995, Kabul had little control over him.

Yet he appears to be on board this time. His 28-year-old commander son, Mohamed Mir Wais Sadeq, is a minister of labour in the interim government in Kabul and Ismail Khan has voiced full support for the government and the UN-sponsored Bonn accords that have laid out plans to elect a more permanent two-year administration for Afghanistan in July.

A proven administrator, if not universally liked, he is already providing aid agencies with a secure environment in which to work, and is making plans to boost the economy. One aide is working on a plan to create a tax-free economic zone for foreign businesses on 20,000 hectares (50,000 acres) on the edge of town. “If Kabul is the center of bureaucracy, Kandahar the spiritual center, then Herat is the center of money,” notes one UN official.

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Kazakhstan

A challenge to the president

Jan 24th 2002 | ALMATY
From The Economist print edition

Democratic Choice calls for changes

AP

Nazarbayev: under pressure

DOMESTIC politics in Kazakhstan, normally uneventful to the point of dullness under the control of the authoritarian president, Nursultan Nazarbayev, have suddenly become interesting. Democratic Choice, a movement set up two months ago, held a rally in Almaty on January 20th attended by several thousand people, the sort of political event the country has not seen in years.

The movement was created by a number of senior government officials, who promptly lost their jobs, and some businessmen. Among their demands are a more powerful parliament, the reform of the judiciary, a free press and television, and the election of regional governors and mayors (now appointed by the president). It is necessary “to eliminate the excessive centralisation of power and concentration of power in the hands of one person,” said Galymzhan Zhakiyanov, who was sacked as governor of the Pavlodar region in northern Kazakhstan after he joined Democratic Choice. Power should be returned to the people, he said, to huge applause at the rally.

The day before the rally there had been a joint meeting in Almaty of leaders of the main opposition parties, among them the Communist Party and the United Democratic Party, and around 800 of their supporters. They called for Kazakhstan to be turned from a presidential into a parliamentary republic, and voted to collect signatures for a petition to hold a national referendum on free local elections.

Old and new democrats have many grievances, but most of them are rooted in a dislike for the excessive influence that Mr Nazarbayev and his extended family are seen to exert on the economic and political life of the country. Appointed officials, they say, do not view themselves as accountable to the people; their primary goal is to please the president. Business people, they claim, are often restricted in their operations as a result of the Nazarbayev family's extensive interests in such key areas as banking, the oil industry and the media. The comparison often made is with the stranglehold that the Suharto family exercised over much of the economy in Indonesia—until a wave of popular protest forced the patriarch to step aside.

How much of a following the dissenters will gain among the general population is a matter of speculation. Yevgenii Zhovtis, a human-rights activist, believes the response could be big. He points to the widespread discontent over the corruption and arbitrariness evident in people's daily dealings with all levels of officialdom, from the police to the courts, and their inability to get redress, a result of a general lack of accountability.

Mr Nazarbayev's seven-year term of office does not end until 2006. But Democratic Choice could re-awaken the public from its torpor. If the 1995 constitution, which enhanced Mr Nazarbayev's powers, could be amended, then maybe Kazakhstan would have a second chance at democracy.

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China and America

The plane truth?

Jan 24th 2002 | BEIJING
From The Economist print edition

It could have been a disaster—but for America and China there is too much at stake

“OUR country is to give birth to an 'Air Force One',” ran the headline of an official Chinese newspaper 17 months ago. Unfortunately, the Boeing 767-300ER—designed to carry President Jiang Zemin and other leaders on official trips—has had a traumatic delivery. Following the discovery of hidden listening devices on board, the Chinese have spent the past few months tearing out its innards to check that no bugs remain. “It is still unusable,” says a Chinese military analyst.

Since reports about the bugging affair first appeared in the foreign press last weekend, both China and the United States have kept their comments to a diplomatic stonewall. Neither side wants to spoil the atmosphere of President George Bush's visit to China late next month. Mr Bush paid a trip to Shanghai last October for a meeting of leaders from the Asia-Pacific Economic Co-operation forum. But his visit to Beijing on February 21st will be his first to China with all the pageantry of a formal bilateral summit.

China's low-key response is intriguing, given how frustrated the image-conscious Mr Jiang must feel. The commissioning of a large jet primarily for his use would have enhanced his prestige in the final months before his presidential term comes to an end early next year. Until now, China's top leaders have used commercial passenger jets on their overseas trips. These are modified to suit the VIPs' needs, then restored to their original state after use.

China bought its presidential jet from Delta Air Lines in mid-2000. The news aroused criticism from the often nationalistic users of China's Internet bulletin boards. Messages were posted criticising the decision to buy an American plane, the (unrevealed) cost of the project and the Chinese media's use of the term ‘Air Force One' to describe the Boeing aircraft. At that time some Chinese were still smarting from the bombing of the Chinese embassy in Belgrade by American planes in May 1999. No such concerns, naturally, were aired in the official press.

Contractors in San Antonio, Texas, refitted the plane for its new role, with Chinese officials on hand to ensure security. But it remains unclear when or by whom the bugs were installed, or when they were discovered. Both sides have refused to comment on details of the incident. Several reports have suggested that the devices were found only after the plane's delivery to China last September. But another version, believed by some Chinese scholars in Beijing, has it that the first discovery was made before the plane even left America, and that it was the Americans who informed the Chinese about it.

Apart from wanting to avoid a diplomatic tussle with the Americans, Chinese officials might simply be too embarrassed to turn this into a public dispute. If bugs were planted in America, it would suggest lax supervision by the Chinese security personnel. Several Chinese air force officers and officials from the China Aviation Supplies Export and Import Corporation are reportedly being investigated. There have also been reports in the foreign media that Chinese middlemen might have profited illegally from the project.

There is also the fascinating possibility that the Americans had nothing to do with the bugging, and that it was related instead to internal Chinese machinations. Mao Zedong's late doctor, Li Zhisui, wrote in a biography of the chairman that in the late 1950s party leaders bugged Mao's guest houses and special train in order not to be caught unawares by his capricious policy pronouncements. China has progressed considerably from the paranoia of the Mao era, but its politics remains highly conspiratorial. Any of Mr Jiang's competitive would-be successors would surely love to listen in on him.

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Terrorism in India

Another provocation

Jan 24th 2002 | DELHI
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The latest attack in India comes at a very nervous moment

AP

Another atrocity, but whose?

TERRORIST attacks in India these days are treated like cases of flu during an anthrax scare. Do they emanate from Pakistan, which India blames for an attack on its Parliament in December? And if so, are they serious enough to warrant the advance of the Indian army, which has been poised to strike across Pakistan's border since then? In the case of the shooting outside the American cultural centre in Calcutta on January 22nd, in which four motorcycle-borne assailants killed five policemen guarding the building and injured 20 other people, the answer to the first question is still uncertain. And even if the answer to the first question is yes, the answer to the second is probably no.

India's hawkish home minister, L. K. Advani, suggested that a group connected with Pakistan's military Inter-Services Intelligence agency (ISI), long a patron of violent anti-Indian groups but possibly now being reformed, was responsible for the attack. Pakistan, which has banned several terrorist groups and forsworn terrorism as an instrument of policy, denies it. There are plenty of terrorist groups without links to Pakistan's government who might have a grudge against America.

Besides, the killers may have been mafiosi rather than terrorists. A man accused of kidnapping a Calcutta businessman last year reportedly called from Dubai to claim credit for the attack. But the line between the underworld and *jihad* (Islamic holy war) is a fuzzy one, Indian officials point out. That alleged kidnapper is said to have links with terrorist groups based in Pakistan. The United States has not accused anyone, or even claimed that its interests were the target of the attack.

Unless Indian investigators prove the direct involvement of the ISI or some other Pakistani government agency, the Calcutta attack is most unlikely by itself to provoke a war. It did not threaten a vital institution like Parliament, nor does it signal a continuation of the insidious infiltration by Pakistan-backed terrorists into the disputed state of Kashmir, which seems to have slowed down lately (perhaps due to snow). The Indian government is alert to the risk that rogue groups might try to provoke war by committing terrorist acts that look like Pakistan's handiwork.

But India's suspicions of Pakistan have so far barely been allayed by the promises of its president, Pervez Musharraf, to stamp out extremism and terrorism. India's foreign minister, Jaswant Singh, says he does not “see any degree of commitment” by Pakistan to fighting terrorism “for the long haul”. The two bristling armies are so highly mobilised that stray shells could spark a wider conflict if they are fired somewhere outside Kashmir, in an area where the terrain is flat and manoeuvre is easy.

The jumpiness is unlikely to abate for a while. It will take time to prove that infiltration has truly stopped. Mr Singh says that the nature of instructions by Pakistan's army to groups operating on India's side of Kashmir have “not changed significantly yet”. The atmosphere would improve markedly if Pakistan extradited at least a few of the 20 suspected terrorists that India claims it is harbouring. Pakistan has so far been cagey about this, hinting that it might hand over some of the non-Pakistanis on the list if it gets enough evidence, but then suggesting that it would counter with its own list of miscreants in India.

The United States, which has not declared itself a victim in the Calcutta attack, is leaning on India not to retaliate against Pakistan without further grave provocation, and on Pakistan to provide no such provocation. It has selfish reasons for wanting to avert war: America is still counting on Pakistan's army

to help mop up al-Qaeda. But the terrorists may be determined to provoke one.

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South Asia

The unmagnificent seven

Jan 24th 2002
From The Economist print edition

SAARC fails to live up to its ambitions

THE latest meeting of the South Asian Association for Regional Co-operation (SAARC) received more world-wide attention than any since the group was founded back in 1985. But long-awaited plans for economic co-operation in the region hardly got a look in. Moves to ease tensions between India and Pakistan that took place at the sidelines hijacked the entire SAARC summit in Katmandu, much to the exasperation of the organisation's other members.

South Asia, home to more than a fifth of the world's population, has the potential to become an area of great prosperity, partly based on the idea of growing trade between SAARC's seven members, India, Pakistan, Sri Lanka, Bangladesh, Nepal, Bhutan and Maldives. To this end a “preferential trading arrangement” was agreed in 1995. But the volume of trade between the participating countries remains tiny. India's exports to the SAARC region in 2000-01 amounted to a paltry 4% of its total external trade, while Pakistan's were a mere 3%. A more ambitious trade agreement on a common market for the whole of the region, originally due to be agreed this year, now looks unlikely to come into force before 2007, if then.

Much of the blame for SAARC's impotence is levelled at India and Pakistan, constantly at loggerheads with each other and thus creating a sense of insecurity throughout the region. But even if the two settle their differences there remains doubt about whether South Asia is ready for the kind of regional co-operation that is developing in Europe, South America and to a limited extent in South-East Asia. The regional trade that exists in SAARC is dismissed as “symbolic”, involving products of little relevance. SAARC members prefer bilateral trade deals rather than acting within a trade block. There have been cases of embassies of the member nations not knowing the address of the SAARC secretariat in their country.

At Katmandu the seven member states signed a declaration condemning terrorism and calling for measures to be taken to tackle poverty. No one is going to get very excited over those routine commonplaces. Some observers have naturally enough started to question whether SAARC has any value at all, and to wonder whether it should be put out of its misery.

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Iraq and its neighbours

Greed, fear and confusion to Saddam's rescue

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From The Economist print edition

The regional obstacles in the way of a change of Iraqi regime

THE performance could be delayed a bit but America is still writing scripts for the exit of Saddam Hussein and his regime. This calls for ingenuity. Iraq has been devastated by an 11-year siege, and made friendless by a government that is widely despised, not least by its own people. But its dictator lives on, helped by a closing of Arab ranks, and by the greed, fear and confusion of many of his foes.

Take greed, to start with. Iraq's predicament has taken an appalling human and economic toll at home, but many of the regional allies that America would need in a war have profited nicely from Iraq's distress. Although the country has vast oil reserves, sanctions have withered investment and throttled exports, allowing competitors, such as Russia and Saudi Arabia, to produce more oil without glutting the market. Over the past decade, Iraq has forfeited potential revenue of some $150 billion, all to the advantage of others.

In addition, oil-importing neighbours, such as Jordan and Turkey, enjoy heavily discounted energy supplies from Iraq. And the Kurds of northern Iraq, who live under semi-autonomous UN protection, have grown dependent on the tidy income they earn from the transit of Iraqi fuel.

All of Iraq's neighbours are agitated, sometimes fearful, about what a change of regime might bring to the region. With Iraq's population 60% Shia Muslim, both secular Turkey and Sunni Muslim Saudi Arabia harbour fears, for different reasons, of the emergence of a fundamentalist theocracy aligned with Shia Iran. The Gulf monarchies would hardly be happy with a democracy next door, either.

Some Americans have spoken of using Iraq's Kurds as a Northern Alliance-like bridgehead to Baghdad. This also makes Turkey nervous. Having squashed its own Kurdish minority, Turkey looks askance at the rewards America might dole out to Kurdish collaborators. It is even more alarmed at the idea of an independent Iraqi Kurdistan that might reignite Kurdish aspirations elsewhere. Perhaps with this in mind, Turkey has taken to muttering about its right to “protect” the tiny minority of ethnic Turks who live in the Iraqi enclave. For the time being, the unprecedented freedom the Kurds currently enjoy, with both Mr Hussein and the Turks kept at bay, may look too precious to risk.

Few doubt that the world would be a better place without Mr Hussein, but a big problem is that those baying for his blood have consistently failed to explain why his removal is an urgent necessity rather than

a desirable outcome. Attempts to link the country to the al-Qaeda terrorist network have not borne fruit, which is no surprise considering that *jihad*-minded Islamists consider Mr Hussein anathema. Nor, in the region, is there much concern about Iraq's illicit weaponry or aggressive tendencies. Kuwait, understandably, remains apprehensive, but Iraq's other neighbours no longer consider Iraq to be a major security threat. The argument that Mr Hussein must go because he hates America and might one day be a danger to it, fails to convince Iraq's neighbours of the need for an expedited change of regime.

The proposed means for bringing this change about are even less convincing than the reasons. America does not, to date, have a legal mandate for serious military intervention. Given the reluctance of Iraq's neighbours, it has no place to install the 100,000 or so troops that might be necessary for Mr Hussein's overthrow. And the Iraqi opposition remains as divided and feeble as ever. The Bush administration's recent suspension of funding to the most pro-American group, the Iraqi National Congress, over suspected financial malfeasance, is a case in point.

Sensing a breathing space, Iraq has launched another of its sporadic charm offensives. Top officials have taken to praising the Gulf monarchies, waxing on the virtues of Arab unity, and even hinting at a future dialogue with America. Mr Hussein himself is said to have proposed some new initiative to Amr Moussa, when the Arab League's secretary-general visited him in Baghdad last weekend. The visit, the first of its kind since the Gulf war, was widely seen by Arab commentators as an attempt to bring Iraq back into the fold at a time when a joint Arab approach is urgently needed to face the consequences of America's anti-terrorism campaign.

Mr Hussein may be spared from this campaign, for the moment. But this does not translate into alleviating the suffering of his people. America's prickly mood has already led to a surge in the number of “holds” put on contracts under the UN's oil for food programme. Some $5 billion in orders, all but a fraction of them intended for humanitarian purposes, now languish undelivered due to American fears that they may serve some military purpose. Meantime, oil prices have fallen 30% since September, and the stringent new mechanism the UN now imposes, whereby prices for Iraqi oil are set retroactively every 15 days, is frightening off customers. The Iraqis' meagre income, already less than a quarter of pre-Gulf war levels, looks set to shrink even further.

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Israel and the Palestinians

It can only get worse

Jan 24th 2002 | JERUSALEM
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A week of killings and the threat of more to come

AP

Horror in Jerusalem

THE Fatah militant who pumped bullets into pedestrians on a Jerusalem street on January 22nd, killing two women, was fulfilling the dire warnings of both Israel and the Palestinians. The Israeli director of military intelligence had told a Knesset committee hours earlier to expect a wave of terrorism of unprecedented ferocity. And that morning in Nablus, Hamas had pledged "all-out war" against Israel.

The Jerusalem shooting was the second attack on Israeli civilians in less than a week. On January 17th another lone gunman stormed into a hall in Hadera, as a family of immigrants from the former Soviet Union were celebrating the *bat mitzva* of their daughter, and killed six people. Both attacks were claimed by the Fatah-affiliated al-Aqsa Brigades in revenge for Israel's assassination of a Fatah activist, Raed Karmi, on January 14th.

In immediate response, Israel bombed a Palestinian Authority (PA) police station in nearby Tulkarm and tightened its armoured siege of Yasser Arafat's headquarters in Ramallah. On January 21st the army invaded Tulkarm in its deepest raid of the 16-month *intifada*, taking over PA offices, arresting 50 Palestinians and killing two during a 30-hour stay. It then mounted a smaller incursion into Nablus, killing four senior members of Hamas's military arm, the Izzadin al-Qassam, and claiming to have destroyed a huge bomb laboratory.

The army said that the four Hamas men, three of whom were on its "most wanted" list, were slain in a shoot-out after soldiers entered an apartment block in search of arms. Palestinians in the block said it was an execution: the soldiers had seized the men in their beds or the bathroom, and shot them through the head. Within hours, revealing an increasing unity of purpose between the Palestinian factions, a Fatah man from near Nablus was killing Israelis in Jerusalem. Later that night, a bundle outside a suburban Jerusalem hall turned out to be a large bomb.

Israel accuses Mr Arafat personally of initiating, or at least countenancing, the new escalation in violence. But the Palestinian leader, shut up in Ramallah for nearly two months and imprisoned in his office for over a week, is caught between the Israelis' assault and his own people's anger. On news of the Nablus killings, thousands of people stormed the gates of a PA prison in Nablus, demanding the release of Hamas prisoners interned as part of Mr Arafat's now futile ceasefire. Palestinian policemen beat them back, killing a protester. Calm was restored when one prisoner—a brother of one of the four Hamas men killed—was freed.

Israel's official line is still that pressure on Mr Arafat can bring him to curb the terrorists. Unofficially, Ariel Sharon is believed to be determined to remove Mr Arafat, and thinks that the Bush administration is now ready to acquiesce. Certainly the Americans are doing little to contradict that assumption. Their peace envoy, Anthony Zinni, seems to be staying put in Washington, despite vigorous Palestinian pleas that he return to the region.

Mr Arafat has pledged "martyrdom in my steadfastness for Jerusalem", while desperately seeking support from where he can get it. There is little to be had: silence from the Arabs, tepid backing from the EU and nothing from the Americans, amid signs that they, like Mr Sharon, have written him off. And what then? "Suicidal armed chaos," says Ahmed Abdul Rahman, one of Mr Arafat's aides.

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Iran's foreign policy

Back into the dog-house

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Helpful, at first, against terrorism, Iran is now being more like its old self

NORMALLY unmoved by western concerns, Iran won America's appreciation for quietly co-operating in the post-September 11th war against terrorism. But that appreciation has now dried up.

Last month, Ali Akbar Hashemi Rafsanjani, a former president, reminded Israel that Muslim countries, armed with nuclear weapons, could easily "annihilate" it. Then, on January 3rd, Israel seized a shipload of what it claims are Iranian arms ordered by Yasser Arafat, through Iran-supported Hizbullah, for use in the *intifada*. Worse, America and some Afghan leaders have accused Iran of making trouble in Afghanistan, and George Bush bluntly warned it not to harbour "al-Qaeda murderers". With its credibility on the rise, why has Iran apparently reverted to type?

A partial answer is that it suits Israel to present things this way: the Israelis would dearly like to see Iran a target in America's anti-terrorist campaign. Consequently, Israel made more of Mr Rafsanjani's comments than they merited: unsettled by a corruption scandal, he speaks for few. And Israel has presented the seizure of the ship, apparently on its way to deliver missiles to the Palestinians, as evidence of a new terror nexus involving Iran, the Palestinian Authority (PA) and Hizbullah.

Diplomats in Tehran, and some frank Iranians, say that the arms cache may indeed have originated in Iran, even if its destination remains unclear. The *intifada*, which improved relations between Iran and the PA, lent heart to Iran's virulently anti-Israel conservative establishment. Ayatollah Ali Khamenei, who as supreme leader sits atop that establishment, no longer calls Mr Arafat, as he once did, Israel's lackey. But few believe that this tentative détente amounts to anything as sinister as the terror nexus Israel has detected.

Charges, aired by America's new ambassador in Kabul, of Iranian interference in Afghanistan also need appraisal. The Afghan accusations come from southern tribal leaders, rivals of their Iranian-backed northern equivalents. It was not long ago that America benefited from the presence of Iran's covert forces in Afghanistan, fighting with the Northern Alliance against the Taliban. More recently, Iran, which has promised Afghanistan $600m in aid over five years, is said to have restrained at least one autonomy-seeking warlord from making trouble for the government.

Although Iran may not be behaving as badly as its enemies make it appear, this does not mean it is behaving particularly well, either. Some ideologues may be seizing the chance, provided by Mr Arafat's weakness, to revive their old ambition of promoting Iran's Islamic revolution as a model for emulation. Moreover, Iran's jitters at the idea of western troops so close to the border may well have led its agents to incite Afghans to agitate against the presence of foreigners on their soil. While other countries secure their interests in Afghanistan, it would be naïve to expect Iran to look meekly on.

The picture is further complicated by the dislocation of Iran's decision-making, which mirrors the reformist-conservative divide that has all but paralysed the country's internal politics. It is perfectly possible for one chunk of the regime to pursue an independent, and unhelpful, foreign policy, without the approval of the other.

If Iran is still some way from being added to the list of Mr Bush's targets, this is partly down to diplomatic protection from Europe. Economics come into this: while sanctions-bound American companies look on, the Europeans have sewn up big deals. But Europe's less worried attitude has also been conditioned by its long engagement with Iran's current regime, an experience denied the Americans.

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Saudi Arabia and America

Time to move on

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From The Economist print edition

Are America's troops over-staying their welcome in Saudi Arabia?

Get article background

EPA

Maybe his last days in a hardship post

TRAPPED between America and their own increasingly ructious people, Saudi princes let slip recently that they would rather the American troops packed their bags. Arab hospitality is famous, but the 4,500 American troops and 1,000 British in Saudi Arabia may by now have outstayed their welcome.

The leaks came apparently from Prince Talal bin Abdulaziz, an ex-communist who holds no formal role in the kingdom. But he is one of the ruling fraternity of sons of the founder of the state, Abdulaziz al-Saud. The American-Saudi relationship, which dates back to his rule in the 1920s, now looks close to foundering. Throughout the cold war, the Americans used Saudi Arabia's fierce and evangelical brand of Islam to hit the underbelly of the Soviet Union, be it in Afghanistan, the Balkans, the Muslim Central Asian republics or Nasser's Egypt. The difficulty came when that same brand of Islam was turned on America.

That Saudi Arabia is willing to risk rupturing its core foreign alliance indicates just how intense the internal pressure from militant clerics has become. Over the past two weeks, say well-placed Saudis, prayer leaders in Riyadh, Jiddah and Burayda, have resigned their official posts in protest at America's continued military presence. The funeral of Sheikh Hamoud bin Oqla al-Shuaibi, the author of the first *fatwa* to declare the royals worthy of excommunication for siding with infidels against Muslims, was the largest the kingdom had witnessed for years.

It is not just the sheikhs. Thousands of people telephoned to comfort the Saudi families of al-Qaeda suspects in American hands, after an Arab web-site posted their numbers. And Saudi-watchers point to a steep rise in violent crime and drug-trafficking as a sign of a breakdown in law and order since September.

In a kingdom whose citizens made up 15 of the 19 men who carried out the September attacks, the princes feel vulnerable. For generations, Saudi youths have been educated on a theological diet that teaches good Muslims to combat *kufr* (infidel) forces. Before children go to school, they can recite the saying of Omar, the second Caliph: “I will purify the Arabian peninsula of Jews and Christians”.

Will America do as asked? The Saudis have been quibbling over America's presence ever since the first troops were flown to the kingdom when Iraq invaded Kuwait in 1990. After the 1996 attack on the marine barracks at Al Khobar, American troops were moved to Prince Sultan airbase in the remote desert between Riyadh and the oil fields. This is now America's largest base in the region. Upgraded last July, it is the command-and-control centre from where the bombings of Iraq and, more recently, Afghanistan are orchestrated.

Yet Carl Levin, the chairman of the Senate's Armed Services Committee, conceded last week that the time may have come to move American forces to a more hospitable base, perhaps Oman. And America's ambassador to Riyadh, in an interview with a Gulf newspaper, pointed out that: “We were going to reduce our troops after the Gulf war anyway.”

Could America be calling the Saudis' bluff? Despite $30 billion-worth of American arms sales to the kingdom in the past decade, Saudi Arabia still resembles a Jemima Puddleduck, helpless before Iraqi and

Iranian wolves. Some observers believe that the princes do not really want the Americans to withdraw, and that the leaks are for local consumption, to regain the al-Saud's battered legitimacy as the guarantors of the peninsula's independence.

But the reality is that the princes' own people are now more threatening to them than Saddam Hussein. Awkwardly, Osama bin Laden's primary aim has long been to evict the Americans from their “occupation” of the Holy Lands of Saudi Arabia. Dead or alive, he may yet succeed.

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Eruption in Congo

Congo's angry mountain

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A natural disaster in a war zone

AP

THE smell was like burning rubber mixed with pepper, and brought tears to the eyes. A six-foot-thick tongue of black lava filled the main street in Goma, heaving in places, coughing up flames and emitting wisps of white smoke. Amazingly, the buildings on either side survived intact. But most of the rest of this Congolese town has been devastated.

Since Mount Nyiragongo erupted last week, spewing out streams of molten rock and shooting balls of orange fire into the night sky, hundreds of thousands of people have been forced to flee their homes. Hordes poured into nearby Rwanda: men leading goats, women carrying sewing machines, children, some with smaller children strapped to their backs, others carrying bundles of manioc leaves. A huge traffic jam built up before the border. As people felt the heat on their backs and saw the menacing red glow filling the sky behind them, they abandoned their vehicles to the flames and scurried across on foot.

For a couple of days, the refugees camped in Rwanda, covering every available patch of land with makeshift banana-leaf shelters. But as the smoke from the volcano thinned, they picked up their belongings again and surged back to Goma. Aid workers were baffled. Goma has no potable water, and little food or shelter. Tremors continue to rattle the place. At least one was strong enough to throw sleeping people up off the floor. Why would anyone return?

Perhaps because it is their home. The people of Goma do not much like Rwanda, which supports the RCD-Goma, the rebel army that controls their town. Some Gomans had been separated from their families, and wanted to search for them. Some wanted to see if their houses were still there, or to protect their remaining possessions from looters-rebel soldiers began to help themselves as soon as people started to flee. Another reason for returning is that the alternative is unpalatable. These people have seen refugee camps before—after the Rwandan genocide of 1994, when hundreds of thousands of Rwandans fled to Goma—and they did not like what they saw: squalor, cholera, bloodshed.

So they walked home, despite the risk. On Monday, a petrol station in Goma exploded in a ball of fire, roasting a crowd of looters as they siphoned fuel into jerry cans. Between 50 and 80 people reportedly died, but the poorest and most foolhardy locals ran barefoot over the burning lava crust towards the fire, desperate to salvage something useful or saleable. One man emerged triumphantly rolling an empty drum: ample reward, he thought, for having his hair singed orange.

The refugees' return has made the distribution of aid far more difficult. Just over the border in Rwanda, two refugee camps set up by United Nations agencies and the Rwandan government stand virtually empty. At first, UN workers hung fearfully back from Goma. But by Monday, UN trucks had started pumping water out of Lake Kivu, so that it could be chlorinated and distributed to thirsty Gomans. Bizima Karaha, the rebels' security chief, while admitting that the refugees' return had complicated the relief effort, complained that help was arriving too slowly. “There are so many pledges,” he said, “But few

things that have been done concretely.”

Goma was not exactly prosperous before the volcano struck. The few businesspeople who work there have long been resigned to having their premises looted from time to time. But Mount Nyiragongo has made things unimaginably worse. The town is in ashes, and the surrounding fields are scorched or buried. Goma's homeless repeat a sad lament: “We need money. We have lost everything.”

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Nigerian economics

Economic theory, African reality

Jan 24th 2002 | LAGOS
From The Economist print edition

A strike over petrol prices shows how hard it is to reform Nigeria

“OUR leaders bleed us dry. They take all our money and give us nothing.” The man mouthing this complaint was Semiu Adebayo, a 50-year-old furniture-maker standing in a picket line in Lagos, but it could have been almost anyone in Nigeria. Mr Adebayo's outburst was prompted by an 18% increase in the state-controlled price of petrol. Nigerian petrol is still among the cheapest in the world, but in a country where the average income is barely a dollar a day, every hike hurts.

The Nigeria Labour Congress (NLC), the main union body, called a general strike in protest last week. The country crunched to a halt. Shops shut, and Adams Oshiomhole, the NLC president, ordered banks to close too, unless they were prepared to hand out free money. Nigeria's president, Olusegun Obasanjo, fought back. The strike was banned and Mr Oshiomhole arrested, possibly illegally, with several of his colleagues. After only two days, the strikers returned to work. The NLC leaders were released, but may have to stand trial.

The apparently arbitrary arrests worried many. But at least the strikers' defeat marked a victory in Mr Obasanjo's campaign for a less distorted economy. Or did it? Pessimists argue that the episode illustrates how difficult it is to enact even obviously necessary reforms in Nigeria.

In theory, the problem is simple. The Nigerian government subsidises the price of petrol. It should stop doing so, for two reasons. First, the subsidy—maybe $2 billion last year—could more usefully be spent on health or education. Second, since subsidised Nigerian petrol costs only a third as much as petrol in neighbouring Niger or Cameroon, much of it is smuggled out of the country. This has led to a chronic fuel shortage in many parts of Nigeria.

So simple, yet so hard

The solution should be simple, too. If petrol prices are freed, as Mr Obasanjo has promised, the treasury will save a fortune, smuggling will cease and shortages will end. In practice, however, nothing is simple in Nigeria. Fearing that sudden liberalisation might lead to riots, Mr Obasanjo has tried to raise the price in stages. In June 2000, he ordered a 50% increase. It led to a general strike, and riots in which several people died. The president was forced to back down, and has remained cautious ever since. This month's increase barely kept pace with inflation.

Petrol subsidies are tough to abolish because they are popular. The poor like cheap bus fares. The petrol-smugglers are well-connected. Many Nigerians feel that, because their country is a major oil-producer, petrol should be affordable. When the government tells them that the money would be better spent on schools, they scoff that it would more likely be stolen by politicians. And when it urges them to tighten their belts, they point out it recently announced a plan to spend more than the health budget on tarting up the building where parliamentarians work.

Another problem is that, after years of neglect, Nigeria's four state-owned oil refineries are dilapidated. They cannot produce enough petrol to meet demand, and no one else is allowed to refine or import the stuff. On January 10th, Rilwanu Lukman, Mr Obasanjo's senior oil adviser, addressed this matter by inviting tenders for licences to build and operate privately-owned refineries. Splendid, but with the price of petrol such an explosive political issue, it will be a brave investor who bids. Mr Obasanjo faces an election in 2003. Will he risk pushing through a policy that is as unpopular as it is wise?

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The European Union

In search of “good Europeans”

Jan 24th 2002 | BRUSSELS
From The Economist print edition

Europe's awkward squad seems to be growing in number

IN A month's time a grand convention to draft a constitution for Europe will open in Brussels. Valéry Giscard d'Estaing, a former French president who will chair the affair, modestly compares it to the Philadelphia convention that gave birth to the American constitution. Many in Brussels see the European version as the culmination of a process of political union that has been unfolding for half a century.

But those in Brussels, Europe's would-be capital, who dream of ever tighter integration are having their reveries more frequently interrupted by disquieting news from the provinces. Their most immediate worry is Italy, long the most reliable of “pro-European” countries. The treaty of Rome in 1957 was the founding document of the modern European Union; the Italians have always been among the loudest cheerleaders for “ever closer union”, the ideal enshrined in the treaty.

Yet Silvio Berlusconi's government is making increasingly sceptical noises about the EU (see table). His ministers have compared their stance on Europe to that of Tony Blair, the British prime minister. To believers in ever closer union, such a comparison is shocking. In the past year Romano Prodi, the European Commission's head, himself an Italian (albeit one who cannot stand Mr Berlusconi), has been driven to near-despair by what he regards as the “theological” opposition of the British to further European integration.

Thumbing their noses at Europe

Country	Trouble
Austria	The far-right is in government – and is against enlarging the EU
Belgium	Has failed to comply with more European Court rulings than any other EU member
Britain	Opted out of euro; reflexively against more integration
Denmark	Opted out of euro, defence, justice. The far-right is gaining ground
France	Blocks economic liberalisation; whines if big jobs don't go to French people; worst EU record on infringing internal-market laws
Germany	Incorrigibly good Europeans. But would Stoiber change things?
Greece	Wants EU to let in a divided Cyprus – otherwise it threatens to block enlargement
Ireland	Rejected Nice treaty in referendum, potentially blocking enlargement
Italy	Government ministers rude about euro; Europhile foreign minister resigned; pulled out of project for European transport plane; tried to block European arrest warrant; blocked agreement on EU agencies; post-fascists in government
Spain	Ruthless in defence of EU financial benefits
Sweden	Out of euro; wary of Brussels deals; iffy about ever closer union

Source: *The Economist*

Some in Brussels still tend to dismiss the Berlusconi government as a European aberration. But they may be complacent. The Italians are not the only traditionally "good Europeans" behaving a bit oddly of late. Last June the Irish voted to reject the EU's Nice treaty, whose ratification is widely regarded as essential to meet the Union's longstanding aim of bringing in as many as 13 new members, mainly from Central Europe. The vote was all the more striking since the EU's opinion polls usually put the Irish, along with the Italians, among the most zealous of Europeans.

So, as the constitutional debate opens, the old awkward squad of Britain and the EU's Nordic countries may be bolstered by Italy and Ireland. Right-wing populists have also been increasingly influencing the debate in Austria (see article) and in Denmark: they too could dampen hopes of faster integration.

In Germany, meanwhile, the nomination of Edmund Stoiber to lead the opposition into September's general election has raised the profile of a politician who, by national standards, is pretty Eurosceptical. Admittedly, this is not saying a lot, given the strength of cross-party support in Germany for closer European union. Like most mainstream German politicians, Mr Stoiber is keen on a distinctly bigger defence, foreign-policy and internal-security role for the EU. But as Bavaria's premier he has often complained about "interference from Brussels", has questioned the concept of a European constitution, expressed doubts about enlarging the Union, and has argued against EU involvement in social policy. Moreover, as a money-conscious conservative, he is unlikely to accept uncomplainingly that Germany should go on being the EU's paymaster-in-chief, especially since it is under growing pressure from the rest of the EU to cut its budget deficit. Even if Mr Stoiber does not actually win the election, he may change the tone of Germany's debate on Europe.

Define good

So how much pan-European political consensus does the EU need? Mr Berlusconi says that his love of the European ideal cannot be questioned; he is simply sticking up for Italy's national interests. That distinction sounds clear. But if too many countries start making it at once, the EU may find it harder to operate.

Indeed, for the next two-and-a-half years, its agenda is likely to be set by a succession of countries whose definition of national interest could make life quite awkward for the rest. This flows from the EU's system of a rotating presidency, which allows each country a six-month stint at setting the Union's agenda and chairing its main council's meetings.

The EU's current president is Spain. That is awkward because the Spaniards have fought tooth-and-nail to keep up the flow of financial aid to themselves, as one of the EU's poorer countries. But now they must oversee the forging of a new EU policy on the amount of regional and farm aid to countries due to join the Union from Central Europe, even though any shift in resources will hurt Spain a lot.

By deferring such big decisions for another couple of years, Spain may get the Union off that hook. But the respite would be brief. Next up for the EU's presidency is Denmark, always oddly placed to tell others what to do, since it has been specially allowed to "opt out" of several of the EU's biggest ventures—on

judicial matters, defence and the single currency.

The Danes' defence opt-out means that Greece, as the next country due to hold the presidency, will chair all EU defence meetings for a year. The Greeks' definition of national interest means that they are slowing progress towards an EU defence policy, because they fear that too many concessions have been made to Turkey, their old rival, which is in NATO but not the EU. That could become particularly dangerous during the Greek presidency in the first half of 2003, if the EU decides around then to admit the Greek bit of Cyprus. Doing so would provoke Turkish fury.

Assuming that the EU manages to get through the Greek presidency unscathed, it then has a year with Italy followed by Ireland in the chair. That too is a peculiarly tricky combination, since the two presidencies will coincide with the moment governments must consider the constitutional proposals drafted by Mr Giscard and his colleagues. A few months ago, fans of ever closer union presumed that a treaty negotiation presided over by Italians would be ideal for ensuring an ambitiously integrationist document. No longer, with Mr Berlusconi in charge. Nor will things be much better if negotiations spill over into the presidency of Ireland, where ardour for integration has dampened.

One awkward EU presidency might be dismissed as bad luck. Might five in a row start to look like a troublesome trend?

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Austria's coalition government

Fraying

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Jörg Haider, Austria's right-wing populist, may unravel the government

AP

No Haider of prejudice

IT IS not surprising, in a country where hostility to nuclear power is widespread, that almost 16% of Austria's voters took the trouble to sign a petition calling for the closure of a nuclear plant at Temelin, across the border in the Czech Republic. What was odd was that the Greens and most other anti-nuclear Austrians refused to sign. Still odder, the petition was promoted by a party that is in Austria's coalition government, which only last month signed a treaty with the Czechs to guarantee better safety measures at Temelin while accepting that the plant would stay open. So what's up? Quite simply, Jörg Haider, who pulls the strings of the far-right Freedom Party that is a junior partner in the coalition, is making mischief.

This has been the pattern of politics within government since Austria annoyed the rest of the EU two years ago by allowing Mr Haider's party, which has been accused of having Nazi sympathies, to become part of the governing coalition. But recently Mr Haider's efforts to distinguish his party from the centre-right People's Party led by the chancellor, Wolfgang Schüssel, have become more pronounced. When Mr Haider's party first joined the coalition, the EU's 14 other countries imposed diplomatic sanctions on Austria, which were lifted only after a report exonerated the government of the charge that it would undermine “European values”.

Freedom Party ministers in the coalition have been trying to implement the government's plans to modernise Austria's archaic administration and to cut its budget deficit to zero. But Mr Haider has been making life hard for them too. Technically he no longer presides over the Freedom Party, nor is he in the national government. Instead, he governs the southern province of Carinthia. But he still calls many of the party's shots in the national arena. In particular, he wants to puff up his party's radical populism, which brought it second place in the last general election, in 1999. Hence the regularity with which he voices dissent against the government.

His Temelin petition was a way of testing the water in the event of a referendum that he has long (but in vain) demanded on whether the EU should take in new countries to the east, such as the Czech Republic. Many Austrians still worry about low-paid workers from over the border coming to Austria to “steal their jobs”—a perfect theme for a populist election campaign.

In the past few weeks, Mr Haider has also demanded that the government (whose finance minister, Karl-Heinz Grasser, is himself a Freedom Party man) should drop its plan to squeeze the public deficit down to zero. Instead, Mr Haider says taxes should be reformed to put money into the pocket of the “small man”.

He has also fiercely denounced the Constitutional Court and its president for ruling that where ethnic Slovenes in his province make up more than a tenth of the populace in a particular community they should be allowed to have place names written in Slovenian as well as German. Road signs to Ljubljana, the Slovenian capital, says Mr Haider, should merely be marked “Laibach”, as the place was called in German when it was part of the Habsburg empire.

This week, Mr Schüssel said that enlarging the EU to the east was one of his government's main aims, while the Czechs' angry prime minister, Milos Zeman, said that Mr Haider's “post-fascist” party should be chucked out of government—a demand that could play into the Austrian's hands. Speculation rose in Vienna that Austria's ruling coalition might collapse, prompting a general election.

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Portugal's ruling Socialists

We got it wrong, vote for us again

Jan 24th 2002 | LISBON
From The Economist print edition

The party's new leader hopes it can win re-election by confessing to its errors

FORGIVE us, voters, for we have sinned. Faint-hearted reforms, policy zigzags, yielding to vested interests, prizing popularity above making hard decisions, pretending that “everything was possible: ever bigger rises in spending power, ever lower taxes”. These are just some of the wrongdoings that Eduardo Ferro Rodrigues is ready to admit that Portugal's Socialist government, in which he was a prominent minister, committed.

Wise man. He has just taken over as the Socialists' leader from Antonio Guterres, who is now merely a caretaker prime minister after heavy losses in local elections last month. Trying to deny or gloss over the Socialists' failings could alienate even more voters in the general election that President Jorge Sampaio has called for March 17th, 18 months ahead of schedule. “We gave the impression that we wanted to stay in office at any price,” says Mr Ferro Rodrigues. “Now we have to tell the country the truth about the situation it is in, and what we plan to do about it.” Most of that truth will be unpalatable. Economic growth will be slower and further cuts in public spending inevitable if Portugal is to keep to the euro-zone rules on public deficits. Property taxes and social-security contributions will have to rise.

The new Socialist leader still dreams of the overall majority in parliament that always eluded Mr Guterres. Unlikely, say the latest polls. Acknowledging that fact, he has publicly entertained the possibility, once taboo, of an alliance with the Communist Party. Its leaders are still stuck in the past but they face a revolt from hundreds of activists pressing for the kind of changes that could smooth the way to a pact with the market-friendly Socialists.

Whether contrition, or even Communist aid on top of it, can win office for Mr Ferro Rodrigues is uncertain. He has been a minister for six years, remark opposition parties: a bit late to repent now. Still, he has not much to lose. He was not his party's first choice as leader, coming to the fore only after Antonio Vitorino resisted strong pressure to give up his job as a European commissioner, and the foreign minister, Jaime Gama, withdrew from contention, citing family reasons. And he has one consolation: Jose Durao Barroso, leader of the centre-right Social Democrats, the main opposition party, is no great bundle of political charisma either. The latest polls put the pair neck-and-neck in popularity.

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Abortion in Ireland

Life choices

Jan 24th 2002 | DUBLIN
From The Economist print edition

Yet another plebiscite on abortion looms in Ireland

FEW issues have so dominated public debate in Ireland, or proved so divisive, as abortion. The weary Irish electorate has endured four plebiscites on the subject in 20 years. In the next few weeks they will face a fifth, intended to tighten already restrictive abortion laws even further.

Last year an estimated 7,000 Irish women travelled abroad, mainly to England, to end unwanted pregnancies. At home, abortion is illegal on all except the narrowest of grounds: where the life of a pregnant mother is threatened because she is suicidal. The entitlement has hardly ever been invoked—only once since 1992, when the Irish courts first established it, in the case of a teenage rape victim. The constitutional referendum is on whether to remove even this limited right.

The campaign is led by Bertie Ahern, the prime minister. A conservative on social issues himself, his coalition government has relied for its parliamentary majority on four independents. Part of the price for their support has been a further referendum on abortion, which Mr Ahern regards as “unfinished business”.

The referendum, if passed, would repeal the 1992 Supreme Court ruling. But, to the dismay of some anti-abortion campaigners, that change would give a higher priority to the mother's life if she is in danger (other than from a suicide threat) than to a fetus's right to life.

Since his election as prime minister in 1997, Mr Ahern has tried to build a consensus for change in this area. But with a general election expected in May, unity is slowly fracturing. His coalition partners remain lukewarm about the proposals, the opposition parties reject them, and divisions have emerged within the anti-abortion movement. This recalls 1992, when a broadly similar anti-abortion measure also created political rifts. Then, an alliance of conservatives and liberals—for different reasons—opposed change and defeated the constitutional amendment by a two-to-one margin.

For Mr Ahern, the referendum is a big gamble. A win would check what he sees as a steady slide towards freely available “social abortion” in Ireland. A defeat, however, would only serve to speed that process up. Moreover, a second referendum loss, following the public's rejection of the EU's Nice treaty last year, would be a very bad start to the unofficial election campaign already under way.

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France's Constitutional Council

Biased, says the prime minister

Jan 24th 2002 | PARIS
From The Economist print edition

France's highest judicial body has annoyed the country's left

WIN some, lose some—but France's prime minister, Lionel Jospin, is losing too often for comfort. The country's Constitutional Council, the equivalent of America's Supreme Court, has just ruled against a key part of his plan to devolve legislative power to the perpetually troubled island of Corsica. Only parliament in Paris, says the council, is constitutionally empowered to pass or amend laws.

That rebuff came just days after the council had rejected a government proposal, in a law on "social modernisation", which would have made it punitively difficult for failing companies to lay off workers. And that in turn came soon after a ruling that the government cannot raid social-security funds to finance a working week it has shortened from 39 hours to 35—with no loss of pay for France's workers. Three losses, then, in a month, coming on the heels of five others since Mr Jospin brought his Socialist-led coalition to power in 1997. What is going on?

The answer, Mr Jospin told the National Assembly this week, is that the Constitutional Council is imposing "political sanctions" on the will of parliament. Arguably so: of the council's nine members, appointed for nine-year terms by the French president, the Senate and the National Assembly, only two belong to the left.

But the cynics think the prime minister is protesting too much. Since several on the left, as well as the right, had reckoned his ideas were constitutionally risky, Mr Jospin could surely have seen the rebuffs coming. In other words, by choosing not to avoid them, Mr Jospin can pose as a victim of the right—and silence those on the left, especially the Communists, who consider him too much the moderate. In which case, as he prepares to embark on his expected campaign for the presidency, the Constitutional Council will have done Mr Jospin a good turn. But in January 1999 it did a much better one for Mr Jospin's scandal-dogged conservative opponent, President Jacques Chirac, declaring him immune while in office from judicial inquiry. Ironically, the council of the day was headed by a Socialist. Mind you, he was Roland Dumas, now appealing against his conviction last year for corruption.

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Russia's media

Blank screens

Jan 24th 2002 | MOSCOW
From The Economist print edition

Russia's last independent television station has folded under state pressure

EPA

WITH a bit of time, money and effort, it is still possible for Russians to be quite well-informed about their country and the world. But it is getting harder all the time. This week, the last opposition-minded national television channel, TV-6, went off the air in mid-sentence when the press ministry switched off its electricity.

The immediate cause was a new twist in an intricate legal battle with a minority shareholder who is seeking to have the station declared bankrupt on an odd-looking legal technicality. The real reason, though, looks different. Closing down a popular and respected station seems strange, to say the least. The shareholder concerned is the pension fund of Lukoil, an energy company with close government ties.

The Kremlin has two arguments. One is that the media will only be truly independent when freed from the pernicious influence of the tycoons. The parent company of TV-6 is owned by Boris Berezovsky, a devious and self-important businessman-politician in the past, who now lives in exile for fear of arrest if he returns to Russia. Journalists at TV-6 mostly joined from NTV, itself once the flagship opposition channel. The national gas company last year wrested it from its founder, another mogul, Vladimir Gusinsky, who now also lives in exile. Both men are controversial figures who used their media empires ruthlessly to advance their political and business goals.

But the anti-tycoons argument would carry more weight if television was now becoming freer under the new regime. It is not. News programmes usually lead with reverential accounts of the doings of the country's leaders. Reporting of topics the authorities dislike, such as high-level corruption and the misbehaviour of the security services (notably in Chechnya), is at best patchy.

The Kremlin's other argument is that these rumpuses are in fact commercial disputes properly left to the courts. Of late, both President Vladimir Putin and his press minister, Mikhail Lesin, have been using this line, even praising TV-6 for its news coverage. If they ditched Mr Berezovsky, they would be allowed to continue broadcasting, journalists there were told by a Kremlin bigwig. Actions speak louder than words, however. If the Kremlin sincerely wanted TV-6 to survive, it beggars belief that Lukoil would persist with its lawsuits or see it removed from the airwaves so abruptly.

Through a screen, darkly

Where does that leave thoughtful or curious Russians? There is still a sprinkling of good journalists and good programmes on all the channels. They include pungent critics of the Kremlin, such as Yulia Latynina, a business journalist on the main state channel, ORT. She describes the government's current policy towards the media as “zombification”.

The best news (see table) now comes from the business press, from the radio and from the Internet. *Ekho Moskvy*, a punchy talk-radio station formerly owned by Mr Gusinsky but now independently owned, survives, at least for now. Its programmes are re-broadcast in the provinces too. Radio Liberty, an American-financed station dating from the cold war which now transmits programmes on local frequencies, has been picking up more listeners. It will soon be broadcasting in Chechen, despite

vigorous protests by the Russian government.

Russia's media market

	What sort	Who owns it	Profitable?	Reach*, m
The free...				
Kommersant	Business daily	Berezovsky & others	Won't say	0.18
Vedomosti	Business daily	Foreigners†	Expects profit in 2002	0.05
Novaya Gazeta	Weekly journal	Gorbachev et al	Unlikely	0.06
Radio Liberty	Radio station	America	na	0.14‡
Gazeta.ru	Website	Won't say	Won't say	0.02
Ekho Moskvy	Radio station	Journalists	Won't say	0.50
...and the easy				
ORT	Main TV channel	State	Won't say	4.90
RTR	Second TV channel	State	Won't say	4.50
Radio Rossiya	Main state radio	State	Won't say	0.99
Strana.ru	Pro-Kremlin website	Won't say	Won't say	0.02

*Circulation, audience, daily hits †Including Pearson, owner of *The Financial Times*, *The Economist*'s biggest shareholder ‡Moscow only

Sources: *The Economist*; Gallup Media; Radio Liberty; www.rambler.ru

Although the Internet is still out of regular reach for the majority of Russians, millions do manage to go on line occasionally, most often at their workplace. They can read the websites of the small-circulation print media, which in physical form have little reach outside Moscow, as well as a slew of Internet-only outfits.

For most of the population, though, the news comes from television. It may be bland, deferential, self-censored and visibly tweaked, but it is not the wholesale propaganda of Soviet times. So long as Mr Putin remains popular, lengthy accounts of his doings may be just what most viewers (and the president) want.

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Russian reform

Pay up, please

Jan 24th 2002 | MOSCOW
From The Economist print edition

Will rich Russians' consciences make them pay more for housing?

A MIDDLE-CLASS Russian should find state charity embarrassing. That is the thinking behind a new advertising campaign in Moscow, urging those who can afford it to pay the full cost of their housing. “Respect oneself and one's city 100%,” runs the slogan.

The payments are for rent and a bundle of services, like heating, water, sewage and building maintenance, all of which Russians enjoyed almost gratis in Soviet times. Most of these are breaking down: at least half the pipes for heating are rotten and need urgent replacement. More than half the country's housing stock is past the end of its planned life. Elsewhere in Russia, there has already been a striking improvement in making people pay. Under a reform strongly backed by President Vladimir Putin, households now cough up 60% of running costs. By next year, local authorities must gather the whole amount, some $40 a month for a typical household.

But poor people can get direct subsidies, which kick in if housing costs are more than a set proportion of household income, ranging from 13% in Moscow to up to 20% elsewhere. Unusually for Russia's creaky public sector, this scheme, introduced in 1994, works better than much of Russia's public sector but is still inflexible and patchy. For instance, if you have a hitch with your resident's permit or other documents, you might get nothing.

But the authorities in the most prosperous part of the country, Moscow, have been dragging their feet over the price rises. They can afford to: the city budget gets no federal subsidies. Thanks to a hefty subsidy (18 billion roubles, or $600m, last year) from the city, Muscovites pay only 45% of the cost of their housing. From next month, though, they will have the option of paying the whole amount.

The campaign is aimed at households with an income of more than 8,500 roubles a month, which make up nearly a third of the city's population. Whether anyone will actually pay up is another matter. The service is both slovenly and wasteful. The awarding of housing-maintenance contracts in the city has been scandalously corrupt. Those who pay taxes (an increasing number, since the introduction of a flat-rate 13% income tax last year) may feel they do their bit already. The scheme was hurriedly thought up. It is not clear what sanctions, if any, will apply in practice to those who plead poverty falsely. The official responsible, Elena Medvedeva, says that if even a few per cent pay up, the campaign will be a success.

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Kosovo's latest proconsul

A ghastly job

Jan 24th 2002 | PRISTINA
From The Economist print edition

Run Kosovo? No thanks

MICHAEL STEINER may have worked in tough places before: he once served in Zaire. But overseeing the UN's protectorate of Kosovo from its capital, Pristina, will certainly be the hardest task the abrasive, clever German has ever faced. Indeed, the rude behaviour (including demands for caviare) during a stop-over last year in Moscow that cost him his last foreign-policy post, as adviser to Germany's chancellor, Gerhard Schröder, will soon be forgotten if he can do a half-decent job in the Balkan province.

After two-and-a-half years of relative peace and intensive international care under the eyes of up to 40,000 armed peacekeepers, Kosovo ought by now to be on the way to economic and political health. But as Mr Steiner will find, there is still an uneasy stand-off between criminals-cum-extreme nationalists and NATO soldiers trying to enforce law and order, and there is no guarantee that the latter will prevail.

Like his predecessors as UN proconsul in Kosovo (first, a Frenchman, Bernard Kouchner, and most recently Hans Haekkerup, a hastily departed Dane), Mr Steiner will have to make very hard choices between cracking down on the region's armed ethnic-Albanian groups and looking the other way for the sake of a quiet political life.

Turning a blind eye, as Mr Kouchner often appeared to do, may be even harder if the toughest ethnic-Albanian factions in neighbouring Macedonia (where Albanians are a large minority) launch a fresh offensive this spring, using Kosovo as a base. These groups are understood to have spent about $4.5m over the last four months on new weapons, including ground-to-air missiles. But standing up to armed bullies, as Mr Haekkerup tried to do, also carries high personal risks. His young family apparently left the tense atmosphere of Pristina with much relief.

Mr Steiner's most immediate task will be to break Kosovo's political impasse. Ibrahim Rugova, the moderate leader who did best in last November's election, has failed to persuade the province's 120 new assemblymen to elect him as president, because his main rivals, Hashim Thaci and Ramush Haradinaj, veterans of the war against Serb forces, want a bigger slice of power. Amid the ferment, a pro-Rugova assemblyman was killed last week.

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Charlemagne

The menace of Vladimir Meciar

Jan 24th 2002
From The Economist print edition

Could the Slovak populist's resurgence slow down the widening of the EU to the east?

Get article background

A LOT of Europeans already in the EU club, particularly the French, are getting volubly queasy about the whole venture of bringing in new countries from the east, perhaps as soon as 2004. They might like an excuse to put on the brakes. What better reason than the return to power of a nasty, authoritarian populist who plainly had little love, when in office after the two bits of Czechoslovakia divorced in 1993, for real democracy, for a market economy, or for human rights, especially for Gypsies and ethnic Hungarians. The latest news from Slovakia is that, if opinion polls are to be believed, Vladimir Meciar has a strong chance of winning a general election due in September.

Much can happen between now and then. And even if he did win it would surely be hard to stem the surge of other Central European countries determined to head westwards into the continent's mainstream. Still, his return to the top of the Slovak tree would pose some awkward questions for countries already in the EU, for those striving to join it, and for the European Commission in Brussels. How strict should the democratic criteria be for letting in newcomers, especially when the governments of a number of countries now in the EU contain, or depend on parliamentary support from, former or actual communists (France and Sweden), post-fascists and xenophobes (Italy), apologists for aspects of Nazi rule (Austria), and parties hostile to foreigners and immigrants (Denmark)?

Doesn't Slovakia deserve a chance? One of Europe's infant countries, its only experience of self-rule until independence in 1993 was a vicious few years as a Nazi puppet state in the second world war. It is understandably a bit more ambivalent about communism than some other countries who suffered under the hammer and sickle. In 1948, Slovaks'GDP per head was 40% smaller than the Czechs'. By 1989, when communism fizzled, the gap had slimmed to 13%. Slovakia's 5m people have been ambivalent about other things, even about independence itself; many think that Czechoslovakia should have stuck together.

In any event, since the Slovaks ousted Mr Meciar from the prime minister's seat four years ago, they and their current government have made their intentions plainer. They want to join the EU and NATO as soon as possible. The EU has given them a provisional green light. Slovakia is being promoted as one of ten countries likely to join in a “big bang” in two years. Even NATO's planners have begun to make encouraging noises. The country offers a land-bridge between two of the alliance's existing members, Poland and Hungary. Slovakia has tried hard to overhaul its army. And pollsters' have recently found that very few Slovaks—unlike Mr Meciar when he was in power—would welcome a return of Russian influence, though many are also wary of becoming too friendly with the United States. NATO people have become warmer to the idea of a “Slo-Slo” option: that is, inducting into the alliance both Slovakia and Slovenia, another country with no previous history of real independence, to offer NATO a neat territorial link between Hungary and the Adriatic Sea. Vaclav Havel, the Czechs' president, reckons that Slovakia might be invited to join NATO under this formula at the alliance's summit he is hosting in Prague in November—provided, he adds, “it is not hit by some tragic reversal of fortune.”

Meaning Mr Meciar back in power. For that could send Slovakia to the back of the queue. His record, last time round, from 1993 to 1998, was pretty bad. Oft-made comparisons with Serbia's Slobodan Milosevic and Belarus's Alexander Lukashenka were over the top—but not by far. He abused the fledgling state's fragile new institutions. He turned a blind eye to corruption. In 1995, when the then president's son was kidnapped, the chief suspect was Ivan Lexa, a secret-service man in Mr Meciar's office, who has since vanished, and may be dead.

Now, however, Mr Meciar portrays himself as both misunderstood in the past and thoroughly reformed now. “I weigh 190 pounds and I'm 6 feet tall,” he chuckles. “Who could be afraid of me?” he innocently asks. His capacity for self-reinvention should not be underestimated. First a dissident, then a federalist, then a nationalist, he now poses as an unabashed “westerner”. No more backwards glances to Moscow; eyes only for Brussels. He speaks fondly of the market and globalisation. What Slovakia needs, he exclaims, is investment from the West, integration with the West. A hatful of old views have been discarded. Was he the fellow who lambasted NATO when it was bombing the Serbs over Kosovo? “Another misunderstanding,” he says.

They won't believe him in Brussels

His political fortune depends on winning over moderate voters in time for Slovakia's general election. His biggest bonus is the unpopularity of the current government, led by Mikulas Dzurinda, who has taken some of the tough economic decisions urged on him by friends in the West and is cordially disliked as a result. Mr Meciar's party is on the rise. It won six out of seven regional governorships in December. Recent polls give it 33%, well ahead of Robert Fico, a slick young law-and-order populist, who is on 13%. At present Mr Dzurinda's party is backed by less than a tenth of voters. Mr Fico says he won't co-operate with Mr Meciar. But it is conceivable that he and Mr Meciar, a dodgy pair, could cut a deal, with Mr Fico becoming prime minister and Mr Meciar, in due course, succeeding to the presidency.

If that happened, it is unlikely that either the EU or NATO would welcome Slovakia into their clubs any time soon, however honeyed Mr Meciar's new vocabulary. The rejection of Slovakia should not, on the face of things, block the entry of other Central Europeans into the West's most popular fraternities. But it could offer a chance for western doubters to start looking more rigorously at the credentials of other fragile democracies on the list—with a view to slowing the whole business down. Mr Meciar's return is not a happy prospect, in any bit of Europe.

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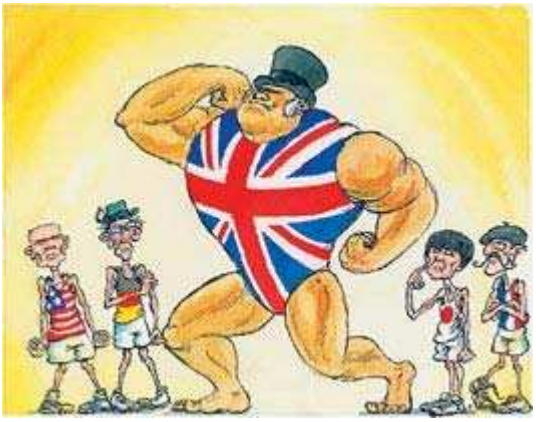
The economy

On steroids

Jan 24th 2002
From The Economist print edition

Britain is out-performing other major economies, but this won't last while productivity remains lacklustre



THE economy has been going though a difficult patch as the global recession batters export-reliant industry. Manufacturing output fell by 5.4% in the year to November, the biggest decline since the dark days of the recession in autumn 1991. A survey published this week by the CBI revealed that industrialists remain gloomy about business prospects, though less so than in October. The first estimate for GDP in the fourth quarter, to be published on January 25th, is expected to show that the economy ground to a halt for the first time since the spring of 1992.

However bad things are in Britain, other big economies have been faring worse. Even with a poor performance in the fourth quarter, GDP growth in 2001 is forecast to exceed 2%. That would mean that Britain outpaced all the other members of the G7 leading economies for the first time since 1986. Remarkably, this out-performance looks set to continue this year. *The Economist*'s panel of forecasters is projecting growth of 1.8%—substantially higher than any other G7 economy.

Whenever Britain does better than the other major industrial countries, there is a rush of blood to the head. In the Lawson boom of the late 1980s, the Conservatives talked themselves into believing they had masterminded an economic miracle. Gordon Brown, the chancellor of the exchequer, makes no such unwise claim. But he does believe that he has devised a better way of managing the economy—compared with both Britain's past and the euro area. And the Treasury is quietly optimistic about Britain's long-run growth potential.

Some of this confidence is justified. Mr Brown's reforms of macro-economic policy have proved successful so far. An independent Bank of England has successfully kept inflation around the government's inflation target of 2.5% a year. It has also been a lot nimbler than the European Central Bank in responding to the world recession. Last year, it cut interest rates more swiftly and deeply than the ECB. A better-designed target regime, which makes the Bank worry as much about an undershoot in inflation as an overshoot, has helped.

The restoration of strong public finances through Gordon Brown's tight budgets in 1997 and 1998 has also allowed the government to boost public expenditure at an optimal moment. Higher government spending is now helping to offset the drag on the economy from falling overseas demand. However, the timing of this injection of demand is largely fortuitous: the government initially intended to relax fiscal policy a year earlier.

In any case, much of the resilience of the economy has derived not from policy measures but from an old-fashioned yet novel consumer boom. Old-fashioned because it is debt-fuelled. Novel because consumers are taking advantage of the fall in inflation, which has brought down interest rates and

so slashed the cost of servicing debt.

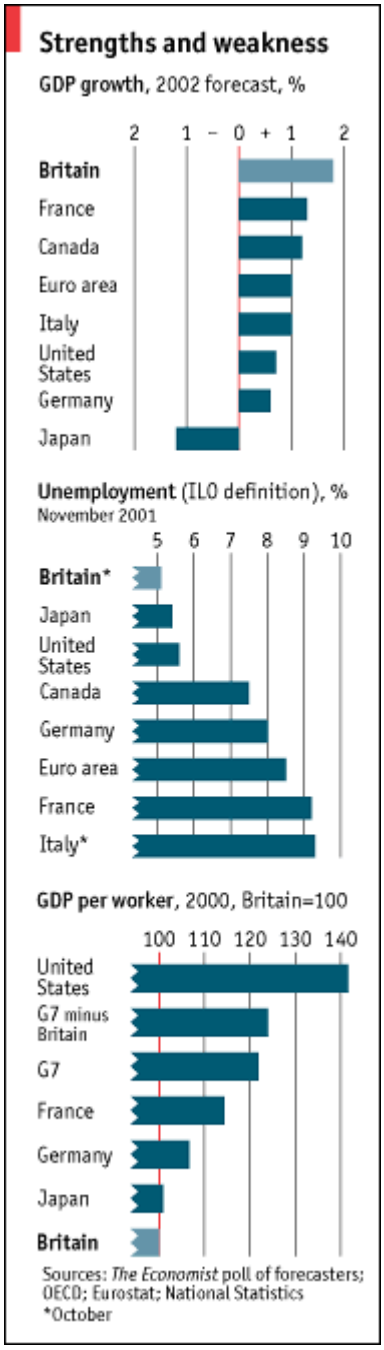
Growth courtesy of a consumer boom is better than no growth at all or recession. But it carries its own dangers. Consumer spending has now grown faster than the economy every year since 1996—the longest sustained period since the late 1980s. This cannot continue indefinitely. True, the immediate interest burden on consumers appears much more manageable than that resulting from previous borrowing binges. But there is a sting in the tail: low inflation means that debt will be eroded more slowly than in the past. When consumers wake up to that, they will have to pull in the reins.

Current imbalances in demand in the economy bear more than a passing resemblance to the late 1980s. Then, domestic demand—mainly consumer spending—outgrew the economy by 6.1%. In the past five years, it has outgrown the economy by 5.7%. This is unsustainable, say some members of the Bank of England's committee that sets interest rates.

Rebalancing demand within the economy is therefore vital if Britain to continue as the strong man of the G7. Exports and business investment need to recover. Consumer-spending growth must slacken. But dealing with the imbalances in demand will not be enough. If the economy is to thrive in the long run, the supply side—the use of labour and capital to produce resources—also has to function better.

One undeniable improvement in recent years has been the labour market. Britain's unemployment rate is now the lowest among the G7 economies. Yet this has not triggered inflationary pressures. This reduction in the sustainable rate of unemployment allowed a rapid growth in jobs in the late 1990s, which contributed strongly to growth.

However, the jobless count is now rising. More important, the gains from vanishing dole queues have largely been exhausted, since few believe that unemployment can safely fall much lower. So productivity—output per worker—must take up the baton in order to sustain growth. But on this count, Britain's recent performance has been disappointing. Productivity in the manufacturing sector is now falling. In the whole economy it has recently been growing by just 1.3% a year. This follows a period of lacklustre performance in the late 1990s.



As a result, Britain's level of productivity remains well below the G7 average. It will not be easy to catch up. The productivity gap is rooted in insufficient capital, poor workforce skills and a failure to innovate as successfully as America. None of these deficiencies can be put right quickly.

Britain may be top of the growth league this year. Inflation is firmly under control and the labour market works better than it used to. But there are uncomfortable echoes of the distortions in demand that occurred in the late 1980s. Until productivity growth improves, the strong man will remain on steroids.

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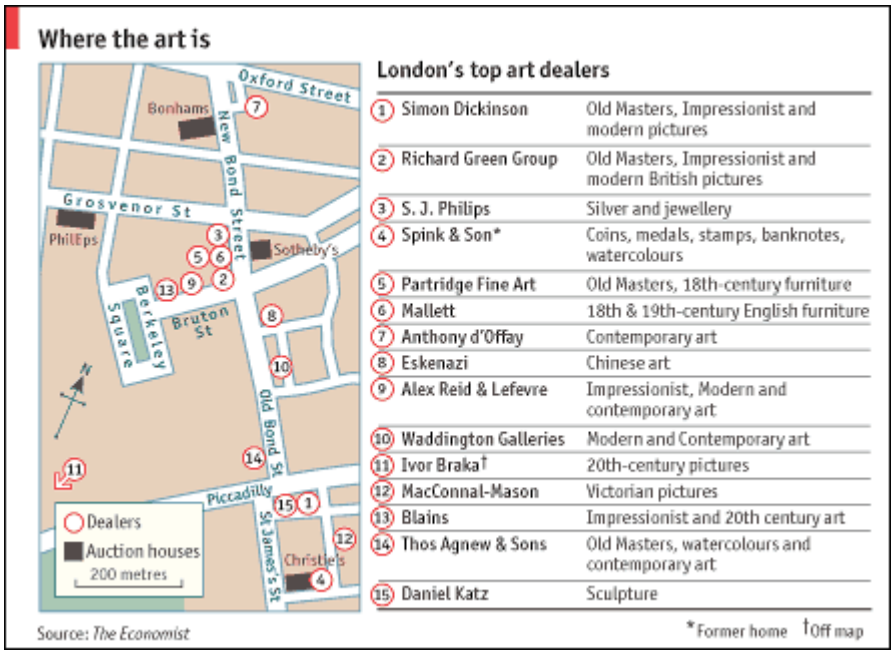
Art market

Let the bad times roll

Jan 24th 2002
From The Economist print edition

Peace, prosperity and Brussels are undermining London's art business

"WHY sweat blood?" inquired Martin Summers of the Lefevre Gallery, announcing last week that his business will close at Easter after 113 years. Alex Reid & Lefevre is Britain's top dealer in Impressionist pictures. Its demise follows several other shocks to the art world.



London's top art dealers

1	Simon Dickinson	Old Masters, Impressionist and modern pictures
2	Richard Green Group	Old Masters, Impressionist and modern British pictures
3	S. J. Philips	Silver and jewellery
4	Spink & Son*	Coins, medals, stamps, banknotes, watercolours
5	Partridge Fine Art	Old Masters, 18th-century furniture
6	Mallett	18th & 19th-century English furniture
7	Anthony d'Offay	Contemporary art
8	Eskenazi	Chinese art
9	Alex Reid & Lefevre	Impressionist, Modern and contemporary art
10	Waddington Galleries	Modern and Contemporary art
11	Ivor Braka†	20th-century pictures
12	MacConnal-Mason	Victorian pictures
13	Blains	Impressionist and 20th century art
14	Thos Agnew & Sons	Old Masters, watercolours and contemporary art
15	Daniel Katz	Sculpture

*Former home †Off map

The top contemporary art dealer, the Anthony d'Offay gallery, has shut up shop. The year before last, Spink, founded in 1666 and bought by Christie's in 1993, was evicted by its parent company from the King Street site it has occupied for nearly a century. Now its jewellery and Chinese art businesses have been closed down, its Indian and Islamic businesses sold and its core business of coins, medals, stamps and banknotes packed off to Bloomsbury, where it is up for sale. Colnaghi's, founded in 1760, was sold just before Christmas to London and Munich dealer Konrad Bernheimer. Sales at Waddington Galleries have fallen from £49m ($87m) in 1990 to £16m in 1999; sales at Thos Agnew & Sons are down from £23m to £8m in a decade.

Despite these shocks, London is still the world's art entrepot; and the square mile of Mayfair and St James's contains a denser concentration of art expertise than anywhere else in the world. Sotheby's, Christie's, Phillips and Bonhams together turn over more lots by volume than any other city's auction houses. New York may have more of the big-ticket van Goghs, Renoirs, Monets, Cezannes and Picassos these days, but London is still the centre for the decorative arts, such as furniture, silver, jewellery and ceramics. Yet there is a change afoot, visible in Bond Street, where art has surrendered to clothes and the street level is now occupied by the likes of Prada, Ralph Lauren and Gucci.

"The whole market is in flux," says James Roundell of Simon Dickinson. "It's not just the trade; there's no certain knowing whether we'll have three auction houses or two by next Christmas." Sotheby's, Christie's and Phillips, the first two in turmoil after an antitrust trial in New York, are all reportedly up for sale. None will comment on the rumours.

The main problem is that half a century of peace and prosperity has drained the art market of goods.

More and more people are trying to sell less and less. Political stability has been a disaster for the dealers, who flourish in troubled times. Death, divorce and distress are their best friends. They long for a bad winter. But few great estates have been broken up lately, and the booms of the 1980s and late 1990s have meant a dearth of bankruptcies.

While this sad state of affairs troubles dealers worldwide, London faces special problems. The EU has introduced a 5% import tax on art, and a 0.25-4% *droit de suite* royalty on sales of works by living painters is on the way. *Droit de suite*, imposed by the French government on dealers, encouraged the business to grow in London rather than in Paris. London's dealers campaigned against its extension across the EU because they anticipated that business would shift to New York and Geneva.

Happily for the dealers, there has been a bit of distress recently. The dotcom crash was widely enjoyed in the art trade: some people went bust and some shifted cash from new technology to old art. But most of it was bought in New York.

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Millennium Bridge

Did it move for you?

Jan 24th 2002
From The Economist print edition

The nation's most famous wobble is about to stop

THERE are few things the British enjoy more than a first-class cock-up, so the saga of the £18.5m Millennium Bridge, London's first river crossing for more than a century, has been a source of general delight. Described as “a blade of light” by its architect, Lord Foster, the link between the City of London and the south bank of the Thames had to be shut three days after the queen opened it because it wobbled too much. It has taken nearly two years, much head-scratching and the fitting of huge viscous damping units to solve the problem. Pedestrian trials over the next two weeks will put the 350-metre suspension bridge through its paces. Provided it has stopped swaying, it will reopen in March.

In the meantime, it has generated plenty of professional *Schadenfreude*. Ove Arup, one of the world's largest and grandest firms of structural engineers, which designed the bridge, has agreed to foot most of the £5m repair bill. Others are also bearing some of the cost.

Before the bridge was opened, Ove Arup said that the response to people walking across it had been thoroughly tested. So it had, on computer models. According to an engineer involved, this had even involved replicating a drunken rugby team deliberately seeking “to excite” the bridge. But no one apparently thought to try out the bridge with real live people.

As soon as it opened, thousands queued to cross it and its tendency to sway became only too obvious. The crowds set off a pronounced lateral movement, so violent that many had to clutch at the bridge's sides to keep their balance. Tests eventually established that the problem was caused by the “syncopated shuffle” of hundreds of pedestrians matching the horizontal frequencies of the bridge. With 156 volunteers marching to and fro, the sway was insignificant. But adding just a few more marchers triggered excessive movement within seconds.

This problem is hardly unknown. All suspension bridges move, some more than others. One of London's most solid Victorian structures, Albert Bridge, still has a notice ordering soldiers to break ranks before marching over it. They, like today's pedestrians, did the “syncopated shuffle”. The Millennium Bridge, which has only eight cables suspending its 144 metres was acknowledged to be pushing at the boundaries of modern structural technology.

Ove Arup claimed that, on the basis of engineering knowledge at the time, the firm could not have predicted the extent of the sway. But a paper by Professor Fujino Yozo of Tokyo University published by the Journal of Earthquake Technology described this phenomenon of “synchronous lateral excitation” more than a decade ago. There were several other warnings. A film of a Maori demonstration on Auckland's Harbour Bridge in New Zealand in the 1970s showed it swaying from side to side. A pedestrian bridge in Paris, the Solferino, had to be closed within days of opening in the 1990s because of excessive swaying.

So why did Ove Arup and those responsible for checking its work not anticipate the problem? Chris Wise, director of the Arup project team which built the bridge, says it is all too easy to be wise after the event. “We consulted widely but no one pointed us in the direction of the problem that developed.”

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Children's books

Regression analysis

Jan 24th 2002
From The Economist print edition

Why adults have taken to children's books

THIS year's Whitbread prize, one of the most prestigious in British literature, has been won, for the first time, by a children's book—"The Amber Spyglass", by Philip Pullman. More copies of Harry Potter books have been sold in Britain than there are children of reading age, and adults read them in public without shame. Children's books have joined house prices and private education among the staples of dinner-party conversation. Are adults getting stupider, or children's books cleverer, or what?

It seems quite plausible that adults, crumbling under the strain of modern living, are regressing. Fifty years ago, the middle classes had servants, and time and energy to devote to their intellectual lives. These days, they need to rest, not to wrestle with difficult books, in the evening.

Adult books, meanwhile, are getting no easier. (Good adult books, that is: the pulp is always with us.) The urge to make the novel novel often leaves readers struggling to follow the plot. Those who favour a plainly-told story have a few high-class modern authors to choose from (Sebastian Faulks, Louis de Bernières); otherwise they must resort to the past, to pulp—or to children's books. Mr Pullman has a serious, old-fashioned attitude to story-telling. "It's craftsmanship. Your aim must be to tell a story as well as you can. You turn the raw materials, and all those loose bits of imagination and experience and memory, into something that stands up like a table with four legs and that doesn't fall over when you put your elbows on it."

While adults struggle with adult books, children's books, like children, are getting more mature. Mr Pullman's work eschews black-and-white morality in favour of moral ambiguity, which makes his books more difficult and more interesting than most children's literature (including the Harry Potter books). Few of his characters are clearly bad or good. His principal villain is the heroine's mother, who redeems herself somewhat. Lemony Snicket, another celebrated children's author, writes books steeped in irony—something adults think rather adult, but children love.

Still, there may be a less intellectual, and sadder, reason. Modern parents do not see their children much. Asked about their lives, children grunt. Reading the same books as their children gives parents the illusion, at least, that they have something in common with them.

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Caravanning

Upwardly mobile

Jan 24th 2002
From The Economist print edition

Caravanning is hip, but British caravans are losing out to slick foreign models

MARGARET BECKETT, the secretary of state for the environment, does it. So do Helen Mirren, an actress, Patsy Palmer, a soap star and Sister Wendy Beckett, a nun and art critic. They all go caravanning. Although the pastime is bracketed in the popular imagination with such archaic entertainments as Butlins summer camps and the Blackpool illuminations, caravanning remains amazingly widespread. Last year more bed nights, 18m in all, were spent in the nation's 1m caravans than in its hotels and bed-and-breakfasts. Some 96,000 people produce and distribute mobile homes and operate caravan parks, which makes caravanning, by employment, a bigger business than the steel industry.

It may be more durable than the steel business, too. Unlike the metal-bashing industries, caravanning is undergoing something of a renaissance.

Caravanning in Britain has suffered from an image problem in the past. In America, wide roads, cheap petrol and excellent camping facilities have made it a comfortable middle-class pursuit. In Britain, it is seen as the last resort for those too poor to afford an overseas holiday. The caravans themselves reflect this. While Americans will pay up to $270,000 for a luxurious, 34-foot-long, motorised recreational vehicle, equipped with king-size bed, satellite television and dishwasher, the standard British caravan is a cramped, engineless box furnished with lurid shagpile carpet, cheap leatherette seating and sofa cushions for beds.

But all that is changing, as Britons take to the sort of outdoor holidays that Americans favour. Peter Frost, chairman of Britain's 100-year-old Camping and Caravanning Club, says that new memberships are at record levels, helped partly by pent-up demand for country holidays following the end of the foot-and-mouth crisis and a greater reluctance to fly after September 11th. Sales of American-branded backpacks, tents and hiking gear are surging, while older people, unwilling to put up with the deprivations of the holidays of yesteryear, are demanding slicker, better-equipped and bigger mobile homes.

British manufacturers are suffering from the change in tastes. While sales of the old British towable model are static, at around 21,000 a year, sales of fancy imported motorised caravans are booming. Around 30% of the 6,000 new motorised caravans sold each year in Britain are imported. The import market is growing at 10% a year. Hymer and Kanus of Germany, Pilote of France and, increasingly, America's Winnebago, whose Adventurer is proving a hit in Europe, are threatening to overtake local producers.

British manufacturers of towables, fighting back, have introduced air-conditioning, full showers and double glazing in recent years. Tony Hailey, managing director of Swift, a manufacturer in Hull, says the styling is better too. “There is less grandma chintz and more of a modern, Ikea-like look with blond wood and pastel colours.” And Mr Frost points to some radical new concessions to holidaymakers. “Sex is finally an option in a caravan, now that there are proper mattresses.”

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City planning

Be bold, be square

Jan 24th 2002 | NEWCASTLE-UPON-TYNE
From The Economist print edition

Northern England's city centres are going European

THE British have never taken to the continental European habit of filling city squares with cafés where citizens chatter amid beer and cappuccinos. The colder climate does not entirely explain why. Amsterdam, a few miles farther north than London, has a thriving al fresco café scene. But this may be changing in northern English cities, which are building new squares based on new ideas.

The latest addition to Newcastle's civic landscape opened on January 25th. It has turned a squalid little space disfiguring the frontage of the city art gallery into a work of art. Instead of just putting down some nice paving stones and a few ornamental tubs, the city council commissioned Thomas Heatherwick, an artist, to come up with some ideas.

Mr Heatherwick paved the space with white tiles speckled with crushed blue glass. The effect is that of a carelessly-thrown giant greenish-blue carpet. A corner laps up a wall. Bollards burst through it. Benches are strips torn out of it, with the resulting holes filled by glass panels with a rainbow of neon lights glowing under them. The “carpet” shimmers at night, under careful lighting.

This is all several conceptual leaps away from the usual British city centre square—a Victorian expanse of paving and statues which has become a roundabout, or a windswept 1960s shopping centre plaza. The usual inhabitants of such places are tourists photographing themselves, and pigeons.

Newcastle's new square, which cost £1.4m, will be certainly used by the locals, if only because it is a walkway between the centre and east-end housing. Manchester's Exchange Square, which emerged out of the rubble of the 1996 IRA bombing is a popular resting place for shoppers, perhaps because it features an urban stream tinkling through stepping stones. Sheffield's Peace Gardens square, which was opened in 1998, is so busy that the council has decided to double its size by tearing down an office block.

Despite much initial grumbling about the £14m cost, the citizens of Leeds appear to have decided that their new Millennium Square, the first such space to be built in the city for 60 years, is a good thing. It was created out of roads, a car park and a bit of garden in front of the council headquarters. It cost a lot because it was built with underground dressing rooms to have an additional use as an outdoor performance space catering for audiences of 15,000. This winter a temporary ice-rink has been installed on it.

Concerts and other entertainments in the venue have been selling out. And the square, which also boasts lots of modern art, seems to have accelerated the regeneration of the city centre. All the semi-derelict buildings around it have been bought by developers. They have paid enough for the council to re-coup much of its share of the square's costs (the national lottery paid for half).

A bit of continental culture is also appearing. Cafés, bars and restaurants are opening fast. Council officials in Newcastle say that a café and a pub have already asked if they can put out tables and chairs on the blue carpet.

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The unions

Déjà vu

Jan 24th 2002
From The Economist print edition

The unions are back—but not as we knew them

THE narrative is familiar to anyone who survived the 1970s: the ballot, the brinkmanship and the collateral inconvenience for anyone caught in the cross-fire. With the contagiousness of old, strikes, it seems (especially to commuters), are back. Along with the current rash of stoppages on the railways, postal workers are balloting about downing tools next month. Tube drivers are grumbling.

Cue lots of talk about a renaissance of militant unionism. In fact, the unions are experiencing a mini-revival—but the strikes have nothing to do with it. If anything, they could jeopardize it.

Surprise at these industrial eruptions is understandable. Throughout the 1980s and 1990s, British trade unionism declined. The Thatcher government's employment legislation weakened the unions' ability to hold employers to ransom. Even more importantly, the restructuring of the British economy—the decline of traditional industry and ascent of the service sector and part-time work, along with the march of globalisation—saw union membership virtually halve. Even when a Labour government was elected in 1997, Tony Blair made it clear that the unions could expect no special favours.

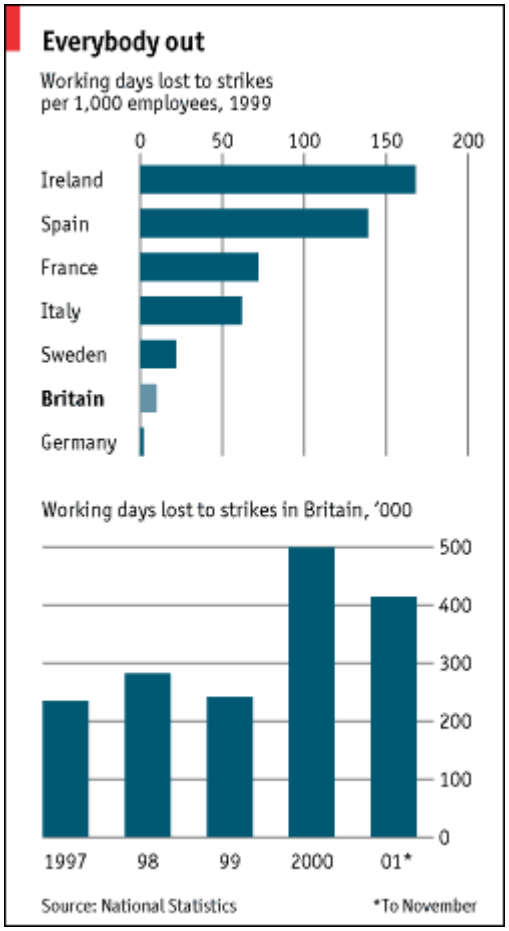
Nevertheless, the government has delivered some of the things, such as a minimum wage, that were dearest to trade unionism's heart. New employment legislation has obliged firms to recognise unions and bargain with them collectively if a majority of the workers want them to. Partly as a result, the number of recognition agreements rose from 159 in 2000 to 470 last year. After a long decline, union membership has stabilised, with job losses in manufacturing compensated by small gains in the service sector, and among women.

John Monks, the conciliatory general secretary of the Trades Union Congress (TUC), says that while strikes are a reminder that industrial relations cannot be taken for granted, they are essentially a mark of failure. “Partnership” with employers—formalised in such deals as the one struck by Tesco, the biggest private employer of union labour—is now the TUC's buzzword. When it is transposed to Britain, a new European directive requiring extensive employee consultation—of the sort that is commonplace in countries such as Germany, but much less so in Britain—will make partnership mandatory.

But although strikes remain rarer in Britain than in many other European countries, and their economic impact is nugatory compared to the great upheavals of the 1970s and 1980s, they too have revived slightly after a few years of even greater calm (see chart). The bellicose transport and post office workers account for much of this growth. As the TUC points out, the railways and the post office are both distinguished by a combination of mismanagement and strong, old-fashioned unions. (The strife on the railways is partly an unforeseen consequence of privatisation: competition for drivers has pushed up their salaries, creating envy and enmity.) So the current stand-offs do not herald a new season of industrial discontent.

Having discovered that privatisation does not protect ministers from the flak of industrial unrest in the public services, the government will hope that this analysis is correct. So will those moderate union leaders who are striving to enlist white-collar workers—many of whom are unlikely to be impressed by the anachronistic bravado of crippling the railways and withholding the

post.



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Bagehot

Will IDS crack too?

Jan 24th 2002
From The Economist print edition

A Tory leader is softening Conservatism's edges. For now

Get article background

OF THE lies that politicians tell, few are as implausible as the assertion that they pay no heed to opinion polls. It is in fact safe to bet that Iain Duncan Smith, the Conservative leader, paid close attention to the devastating finding of an ICM poll published in the *Guardian* on January 22nd. This poll showed...not much. It showed not much change over the month in voting intentions: Labour was up one point, at 45%; the Tories up one at 30%; and the Liberal Democrats down one at 19%. It showed not much change in the towering cross-party reputation of the prime minister: more than one out of three Lib Dem voters and one out of four Tory voters think that Tony Blair makes a better premier than their own man would. The poll was devastating because it followed a month during which the Tories had been basking in a rare shower of favourable press commentary. Was the post-Christmas Conservative recovery under "IDS" just a space-filling fantasy cooked up by the newspapers?

Not once you remember the bleak place Mr Duncan Smith started from. His election as leader last September was greeted on many sides of the Conservative Party as a suicidal folly. Given that the previous leader, William Hague, had been shattered in a general election which he fought promising to "save the pound", why choose a successor even more hostile to the euro? Given that Labour had successfully branded Mr Hague a right-wing extremist, why choose a successor who thought well of hanging and flogging? Mr Hague lacked charisma but was good in Parliament; IDS, went the bitter joke, just lacked charisma. Some Tories said the party could split if IDS did not smartly rebuild relations with the pro-euro Tories who had backed Ken Clarke. He chose instead to appoint to the shadow cabinet not just arch-Thatcherites such as Michael Howard but also Bill Cash, arguably the most monomaniacal europhobe Toryism has to offer. Doom was surely nigh.

Measured against these expectations, Mr Duncan Smith has indeed done well. His party has not split over the euro. Despite (or because of) Mr Cash's presence in the shadow cabinet, it no longer emotes obsessively about this subject—and may not need to for so long as adverse opinion polls put Mr Blair off risking his promised euro-referendum. Nor has IDS come over as an extremist. A Liberal Democrat strategy paper leaked to the press last November concluded that since the Tory leader was failing to present himself as the "barking rightwinger" the Lib Dems had hoped for, they should emphasise instead that "he's just not very good". But although he is not very good (actually, he's awful) at baiting Mr Blair in the House of Commons, being excellent at this did little to help Mr Hague. In the media, where it does matter, the plodding IDS has already received more sympathetic notices than his brighter but fatally unserious predecessor, who was disparaged from the start as a figure of fun.

Even by the Tories' standards, not being called a twit by the media is a necessary rather than sufficient step towards recovery. But Mr Duncan Smith can point to a more solid achievement. He is repositioning his party. Mr Howard, as shadow chancellor, has said that fixing the public services might need to take precedence over tax reductions. Oliver Letwin, shadow home secretary, has used the "war against terrorism" to outflank Labour as a defender of civil liberties. Having opposed most of Labour's constitutional changes, the Tories pose now as democracy's true champions, calling for the creation of an elected Senate to replace the House of Lords and for Parliament to be allowed to scrutinise public appointments. Mr Duncan Smith refused to join the Carlton Club because it does not admit women. John Bercow, a former member of the anti-immigration Monday Club, told his constituents that Tories were seen as racist, sexist and homophobic and had better change their ways. There is revolutionary talk of positive discrimination in favour of women and blacks seeking selection as MPs.

Seeping

Not all of these messages have been co-ordinated as deftly as they could be. Mr Bercow says that Tories should stop being bigots; Mr Duncan Smith says that Tories are not bigots. And the party is still nowhere near to explaining exactly how its approach to public-service reform would differ from Labour's. But the general message of a party in transition is seeping through. Even that otherwise dismal ICM poll shows a small fall in the percentage of voters who think of the Conservatives as a right-wing party hostile to the public services. Whatever Mr Duncan Smith's inner beliefs, he has at least understood that the Tories will get nowhere until they soften some of the harder memories of Thatcherism. In recent pronouncements, he has even stolen one of the formulae Mr Blair uses to explain New Labour's ideological U-turn (our policies change but our values are eternal).

All this is fine, so long as it goes on. But remember that Mr Hague tried for a while to march down just this path. He also made a lot of speeches apologising for letting Conservatism come to be seen as a harsh doctrine that cared only about economics and not about people. He put on a baseball cap at the Notting Hill carnival. He sent Peter Lilley, another arch-Thatcherite, to “listen to Britain”, and cannot have been surprised when Mr Lilley reported back on the need to renounce much of what Thatcherism had come to stand for. But then Mr Hague panicked. A blast from Lady Thatcher blew Mr Lilley out of the shadow cabinet. The absence of movement in the polls tempted Mr Hague to play up issues—asylum, crime, the euro—that won the praise of the Tory faithful but repelled many floaters.

The rest is history, which IDS may or may not repeat. In a few years, he too could face the testing moment when the polls refuse to budge and a general (and leadership?) election nears. Mr Hague panicked, and changed course. Mr Duncan Smith might just be dogged enough to plod on.

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Media giants

Who's afraid of AOL Time Warner?

Jan 24th 2002
From The Economist print edition

For all its size, AOL Time Warner has failed to redefine its industry by blending old media with new

Get article background

ONLY six months ago, the merger of AOL and Time Warner was reshaping the media industry, for two main reasons. First, because of its size: it was more than twice as big as its nearest rival, Viacom, and everybody else was scared of being trampled under the sheer weight of the new group. And second, because AOL Time Warner seemed to be redefining the nature of media itself, through its fusion of old and new. At that time, most activities of other big media groups—whether News Corp's obsession with snapping up DirecTV, a satellite broadcaster (which, for now, it has failed to do), or the attempts by Vivendi Universal, a French media giant, to secure distribution in America (which it has done)—could be explained by their need to stand up to AOL Time Warner.

Today, however, things look a little different. Having spent last year promising miracles, the group is this year learning the virtues of modesty. Earlier this month, when explaining a one-off charge of $40 billion-60 billion that he attributed to new accounting rules, Richard Parsons, who will take over from Jerry Levin as chief executive in May, struck a studiously cautious note. Sprinkling his speech with such words as “conservative” and “prudent”, he said that revenues for 2001 would reach $38 billion, only 5% up on 2000 and less than previously forecast. Last year, he said, “we got no credit for our achievements because of the high expectations we ourselves created.” This year, “we will not overpromise, and we will deliver.”

How far should this fresh humility soothe rivals' fear of AOL Time Warner? Since the merger was announced in 2000, the company has lost more than half its market capitalisation, less than new-media outfits such as Yahoo!, but more than other media giants such as Disney. Yet AOL Time Warner is still worth $121 billion, retaining its position as the world's media colossus. This gives it huge clout in negotiations over the carriage of other people's content down its own pipes (it reaches over 147m subscribers through such channels as Warner Cable, HBO, the WB Network and AOL), and over the carriage of its content (Warner Music Group, Warner Brothers films and television, and Time Inc) down other people's pipes.

This market power is not to be sniffed at, but it is not what the group claimed to be about when its merger was announced. Then, the talk was all about harnessing the dynamism of the Internet, and the entrepreneurial spirit of the geeks from AOL, under their boss, Steve Case, to revitalise the rather frumpy old-media assets of Time Warner. “Synergy” was the buzzword, the idea being to blend content from the disparate bits of the empire, and to blur the edges of old media, such as television, music and film, into a single dizzying multimedia experience.

In some respects, this has been achieved. The most recent example was the release in December of “The Lord of the Rings”, the first of a trilogy of films, by New Line Cinema, part of the AOL Time Warner kingdom. This film has already taken $246m at the American box office, and was the fourth-biggest hit of 2001. Together, AOL and New Line created a “community” of fans who were offered a tantalising advance snippet of the film on the Internet in April 2000; this was downloaded over 1.7m times. To keep them coming back, the official website is continuously updated, and will feed visitors a steady supply of exclusive morsels throughout the life of the trilogy.

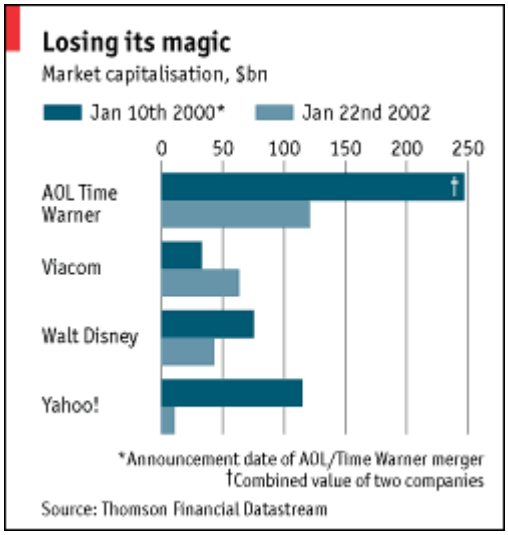
AOL subscribers, however, were treated to more: a chance to enter a competition to be flown to the movie's world première in New Zealand (where it was filmed)—if, that is, they upgraded to AOL 7.0. In two weeks, 800,000 community members signed up. Few corners of the AOL Time Warner empire have not been turned into marketing outlets for the film. Given that yet another of the group's films, Warner Brothers' “Harry Potter and the Sorcerer's Stone”, broke box-office records last year, and that both films have brought in lucrative merchandising and licensing deals, this might look like vindication of the AOL Time Warner synergy model.

Certainly, the cross-promotion of assets within a large media group can be potent, especially when exclusive offers are made to insiders, such as subscribers to AOL. The addition of the AOL distribution channel, after all, with its more than 30m subscribers, was part of what lured Time Warner's Mr Levin into the merger in the first place. But this in itself touches on a crucial limitation to the synergy model.

The content conundrum

The group's marketing types, with a routine nod to the regulators, have always stressed that they will not shut out competitors' content, nor crassly favour their own. As Bob Pittman, co-chief operating officer and the man Mr Parsons pipped for the top job, put it: “We're not great believers in exclusivity: it's not what consumers want.” This makes sense. Readers of *Entertainment Weekly* no more want reviews of only Warner Brothers films than subscribers to the new AOL Music will want only artists signed up to Warner Music labels. So *Entertainment Weekly* reviews all studios' films, and AOL Music will offer music from non-Warner labels too.

Indeed, parts of the empire are prickly about the very idea that they might favour in-house content. “We aren't a promotional tool,” snaps Don Logan, the pugnacious head of Time Inc, which owns such titles as *Fortune*, *Time* and *Sports Illustrated*. The merged group's bosses have had to adjust to jealously guarded editorial independence. It is to AOL Time Warner's credit that the group tolerates critical coverage of itself in its own pages. “AOL Time Warner could end the year with one of those booby prizes that companies loathe: the record for losses in the Fortune 500,” says a harsh article in the latest edition of *Fortune*.



Moreover, in their efforts to promote their own content, the various bits of the group do not always choose their corporate siblings. Warner Brothers Television, for instance, distributes “Friends” not via the group's own network, the WB, but through NBC, a far larger network owned by General Electric. Group divisions are quite prepared to promote rivals' content. Despite not being signed to Warner Music, Britney Spears has a deal to supply exclusive content to the AOL Music website. And the latest international edition of *Time* has “Ali”, a movie from Sony's Columbia Pictures, splashed on its cover.

If there is only a limited compulsion to promote your own stuff over that of others, however, the case for owning it all in the first place looks a lot weaker. There are still virtues in belonging to one group, such as less time spent squabbling over the division of spoils from cross-promotion. The assembly of all these assets under one roof still gives AOL Time Warner plenty of leverage in negotiations over, say, distribution rights. Other than that, about the best rationale that can be made for the merger is that the injection of AOL's livewire Internet attitude into the more old-fashioned bits of the group has reinvigorated their marketing. “All these businesses were so hidebound in the way they promoted themselves,” says Mr Levin. “You put in AOL and the effect was extraordinary.”

Even the group's decision, announced on January 22nd, to sue Microsoft for the harm its anticompetitive behaviour inflicted on Netscape, a rival software company now owned by AOL, could be regarded as evidence of AOL's weakness rather than its strength. As well as claiming vast damages, AOL hopes to use the suit to slow Microsoft's advance into new areas—such as music, video and messaging software—and to push its own software instead. Some observers say this shows that AOL would now rather compete in the courts than in the market.

At least AOL Time Warner is a more integrated outfit these days. With the fortnightly meetings that division heads now attend, a fragmented collection of businesses employing some 90,000 people has

become a little more co-operative. But the choice of the charming and diplomatic Mr Parsons to succeed Mr Levin over the more abrasive Mr Pittman says a lot about the limits to such banging-together of heads. As Jeff Bewkes, head of HBO, the subscription-television channel responsible for such hits as “The Sopranos” and “Sex and the City”, puts it: “You could say that we weren't co-ordinating enough before. But we had very strong businesses, and they weren't hobbled by over-centralised management.”

Getting division heads to talk more to each other, and to make more joined-up use of their websites: these are handy management tools. But they hardly add up to a redefinition of the media industry.

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Car retailing

Driving a hard bargain

Jan 24th 2002
From The Economist print edition

The European Commission's new rules will loosen car makers' hold on dealers

EUROPE'S car companies, reeling from overcapacity and weak prices, are about to suffer another shock, this time at the hands of the European Commission. Within the next two weeks the commission is expected to unveil its plan for a shake-up of car retailing in the European Union (EU). Previous attempts at reform have been watered down by industry pressure. This time, the commission is likely to get its way. Behind the dense, technical language of the new regulation—a draft of which, dated January 7th, *The Economist* has seen—lies a clear intention to increase competition, create a single market and stop the car makers using their dealer networks to prop up high prices in some national markets, such as Britain.

At present, the car companies enjoy immunity from normal antitrust rules under a so-called “block exemption”. This allows them to sell cars only through selected dealers, each with exclusive territories. Dealers may not stray beyond their patch, and the car companies can stop them competing with each other.

The commission finds fault with this on several counts. The main complaint is that it restricts parallel imports that could eliminate national price differentials and create a single market for cars across the EU. The present rules also inhibit the adoption of new marketing methods, such as Internet sales, or the sale of new vehicles through multi-brand dealerships. And the rules inflate the price of spare parts, which dealers have to buy through car makers rather than direct from parts makers.

The new regulation will no longer allow the combination of “selective” and “exclusive” distribution used by manufacturers “to impede parallel trade and price competition within the common market”. At the moment, the car makers can choose dealers according to their quality (for instance, the state of their premises), reject new dealers if they think a locality already has enough, and stop dealers touting for business outside their allotted territory.

In future, dealers will be able to choose between selective and exclusive distribution. They will thus be free to seek customers wherever they can find them, including in other EU countries. If a car company opts to run an exclusive-territory system, its dealers will be allowed to re-sell cars to other retail outlets, such as supermarkets.

Other changes include the removal of the requirement that dealers must offer after-sales service and repairs. Dealers will also be free to sell different makes of car, provided they have a separate showroom area for each brand. And their new freedom to sell into other EU countries will quickly erode price differentials, which often exceed 20%. The commission is also proposing new rules that will loosen the stranglehold that some national champions, such as Volkswagen and Fiat, enjoy in their home market.

The only consolation for the car companies is that the commission plans to leave some barriers to entry intact. The regulation acknowledges that, if supermarkets were allowed to become distributors under both the “selective” and “exclusive” system, prices might fall in the short term, but in the long term “it would lead to a strong concentration in the distribution sector with higher prices.” John Wormald of Autopolis, a car consultancy, points out that, although the new rules will not throw the doors open to everybody who fancies selling cars, its main aim is to encourage consolidation among dealers, with a full opening to come later.

The commission's formal decision is due on February 5th. The new regulation is expected to take effect in October. Some countries with big car industries, such as Germany, may complain, but they are unlikely to persuade the commission to water down its new rules. As a regulation (rather than a directive) the

new regime can come into effect without the delay of having to be incorporated into domestic law. It looks as if the car makers will simply have to go along with the upheaval to their cosy system. Perhaps they should be thanking Brussels: for years they have talked of rationalising their dealer networks, but without lifting a finger.

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Mobile telephones

From cell-phones to self-phones

Jan 24th 2002
From The Economist print edition

Mobile phones are increasingly aimed at specific types of user

THE Nokia 5510 looks like a curvy spectacle case adorned with small silver studs—the keys of a tiny keyboard for quick and easy typing of text messages. It also has a built-in radio, a digital music player and a selection of games. For the user whom this handset is aimed at—young, fashion-conscious, keen on text-messaging and music—the ability to make voice calls is almost an afterthought. The 5510 is at the forefront of a trend, as handset makers add nifty features to their phones to appeal to different customer segments.

Oh, and the 5510 also makes phone calls

Nokia, the largest handset maker, owes its dominance in part to its early realisation that mobile phones would evolve into fashion items, and that different users would want different features. But now everybody is at it. Siemens makes phones with built-in music players. Ericsson's T68, with a built-in colour display for better games and graphical messaging, is selling fast. There are even rubberised phones aimed at sporty types, and organiser/phone hybrids for business users.

Some attempts to design phones for particular users are more subtle than others. Consider Samsung's tiny A400 handset, which flips open like a make-up compact, and is available in a special red “feminine” version, known as the Ladyphone. The name alone is enough to raise eyebrows, but wait until you see the special features: a biorhythm calculator, a fatness function that calculates a user's height-to-weight ratio, a calendar for keeping track of your menstrual cycle and a calorie-counting function. Enter an activity (cleaning, dishwashing, cooking, shopping) and the time spent, and the phone works out how many calories have been consumed—provided your activities are limited to those of a dutiful housewife.

Such silliness aside, the proliferation of weird and wonderful phones is driven by a big change in the business. As penetration of mobile phones rises (it is above 80% in some parts of Europe), phones are increasingly being sold to replace users' existing handsets, rather than to first-time buyers.

According to Farid Yunus of the Yankee Group, a consultancy, replacement purchases now account for some 62% of all handset sales in Western Europe; that will rise to 99% by 2006. Fancy new functions are a way to tempt people to upgrade often. Features such as colour screens, built-in digital cameras and music players might also encourage consumers to start using advanced data services.

As the choice of phone becomes as important a social signifier as the choice of car, handset makers, like car makers before them, are segmenting the market more finely. Nokia, the most sophisticated manufacturer in this respect, divides consumers into 14 categories, and plots its phones on a five-by-seven grid. Moreover, it is still adding new categories. This week the company launched Vertu, a subsidiary that will make hand-crafted luxury phones for the mega-rich. Its first handset, with platinum casing and a sapphire crystal screen, can be yours for a mere $21,000.

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Japanese careers

Show me the money

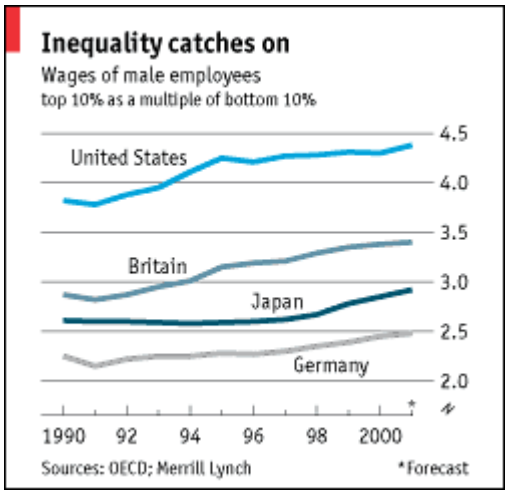
Jan 24th 2002 | TOKYO
From The Economist print edition

Japanese talent is increasingly being rewarded. But start-ups are still a rarity

IT ALWAYS helps to know what your options are. Hence the popularity of a late-night Japanese television show called “Kyuyo Meisai” (“Payslip”), aimed at beleaguered salarymen. Every week, viewers get to see how much people earn in various careers, from disc jockeys to female wrestlers. These may not be realistic alternatives for most browbeaten white-collar workers. But corporate Japan is changing in ways that do give those workers more options—and, more importantly, payslips that reflect their worth.

The change began in the mid-1990s, when foreign investment banks and technology firms first competed successfully for Japan's most talented young professionals. But more recently, a growing number of local companies have responded by introducing their own systems of merit-based pay. These are still a far cry from the performance-driven incentive schemes used in many American companies, but they are nevertheless allowing Japanese firms to shed their rigid career structures and seniority-based pay scales.

These changes are now beginning to show up in the data, as competition for white-collar talent increases pay inequality (see chart). The effects are also being seen in Tokyo's property market: despite a battered economy, the most talented professionals continue to snap up top-end flats with their rising pay cheques.



Might this talent chase prompt bigger changes in Japanese companies? The most obvious drawback is the difficulty that young Japanese have striking out on their own, thanks to red tape, a financial sytem that fails to turn savings into venture capital, and a legal environment that brutalises business failures.

In other rich countries, rejecting established employers to join a start-up is the best option for many clever young business minds. By that test, Japan still lags behind. Fiachra MacCana, head of Japanese research at WestLB Securities Pacific, points out that new firms make up only 4.5% of the total in Japan, compared with an average of 10% in the European Union and more than 11% in the United States. Moreover, despite a brief burst of Internet activity just before the technology bubble burst, that share has fallen over the past decade. Without a more attractive exit route, young Japanese professionals must still settle for the gradual changes occurring inside established companies.

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Power in Central Europe

Generating distrust

Jan 24th 2002 | PRAGUE AND WARSAW
From The Economist print edition

Across the region, the sale of national electrical utilities has been botched

UNSHACKLING electricity networks from the state can be a horribly sluggish process. Just look at France, which is keeping its domestic market largely closed while its state-owned monopolist, Electricité de France (EdF), snaps up utilities in other countries. But even the sternest of EdF's critics would share its exasperation with the Czech government's recent attempt to sell CEZ, the country's dominant electricity producer. As with a number of other Central European power privatisations, this was a half-baked affair.

Structured as a bundled winner-takes-all sale of a majority stake in CEZ, the Czech national grid and six distribution companies, the tender was lambasted for making a mockery of competition just as market liberalisation kicks in. Among the sale's conditions were an eight-year ban on asset disposals, enforced production and fuel-consumption levels, and the inclusion of a Soviet-designed nuclear plant.

No wonder the government has decided to scrap the auction. Yet this is a pity, as CEZ is a big prize given its cheap generating capacity and booming exports to neighbouring Germany. Its sale initially attracted some of the biggest names in the industry and could have brought in $5.5 billion. But half the bidders, including Belgium's Electrabel and a consortium led by International Power, E.ON and British Energy, eventually withdrew or flouted the tender rules by bidding for the assets in pieces. The details of a joint bid by Italy's Enel and Spain's Iberdrola were mysteriously made public by the government.

It is now hard to find a foreign operator that is happy with the way governments in Central Europe are opening up their power markets. The litany of grievances includes a lack of regulatory and price transparency, difficulties in enforcing contracts and an array of political and trade-union-related woes. “Investors are second-guessing from day one,” says Nigel Robinson of CA-IB, one of the region's biggest investment banks.

Even Hungary, the region's most avid energy privatiser, has incurred the wrath of western companies. Although it sold all its electricity assets (except the national grid) in one go in 1995-97, it later reneged on long-term power-purchase agreements signed at the time of privatisation. The government, with some justification, insisted that these agreements (highly priced contracts between generators and the grid) have no place in a liberalised market. This prompted AES, an American power giant, to sue Hungary's grid. Although an out-of-court settlement was reached last month, the bust-up tarnished the government's credibility among investors.

Poland, with by far the region's biggest market, has also come in for criticism. Perennial delays in liberalising prices, coupled with a heavily regulated market for the coal that fires power plants (all mines are state-owned and most are in dire financial straits), have chased away many private investors. Even the gutsy ones, such as Minneapolis-based NRG, whose year-long bid for the Rybnik power plant in 2000 nearly paid off, have bowed out after failing to secure a competitive return.

State-owned investors, it must be said, have fared better. EdF and Sweden's Vattenfall have pulled off big deals in Poland, aided by indulgent shareholders. But they had to sign lavish social packages with Poland's combative trade unions, involving five-to-ten-year employment guarantees. The sale of a cluster of distribution companies tripped up Iberdrola last year when it had to negotiate a social pact with the unions of eight individual suppliers.

For all the pitfalls, however, there are a few bright spots. Some Central European governments that previously shied away from privatisation are now thinking again as they prepare to join the European Union. Mr Robinson is impressed with Slovakia, which has lagged behind its neighbours, but is now throwing its assets on the block. “They're very consistent, and there's even a degree of humility,” he

says—something which would not go amiss in Prague, or among Poland's union bosses, for that matter.

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Boeing's bleak outlook

It's a desert out there

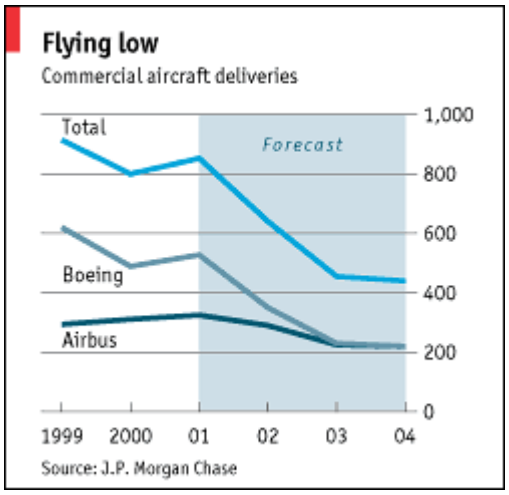
Jan 24th 2002 | CHICAGO
From The Economist print edition

The world's biggest aircraft maker is losing ground to Airbus

EARLIER this month Boeing's 150 top managers went to Palm Springs for their annual jamboree. If they needed reminding what was the biggest issue hanging over the meeting, they had only to glance down, as they flew in, at hundreds of their products parked in the Mojave desert: unwanted aircraft that have been arriving for storage since the airline recession started last summer. Boeing's chairman, Phil Condit, thinks the jet parking lots could remain full for another three years.

Although Mr Condit was able to announce satisfactory full-year results for 2001 this week, it is clear that hard times lie ahead. Boeing's pre-tax profit rose by 19%, even after a $935m charge to cover the cost of laying off more than 30,000 workers since September. But revenues are now forecast to fall from $58 billion last year to $52 billion in 2003, as orders for civil jets fall (see chart). The only airlines still doing well and buying lots of aircraft are the low-cost carriers, a fact underlined by Ryanair's order for 100 Boeing 737s this week, in a deal worth over $3 billion.

Despite this boost, Boeing has a smaller production backlog than Airbus, its European rival. Unless Airbus suffers a disastrous rate of cancellations, it could overtake Boeing in both production and deliveries within a couple of years, for the first time. Airbus has occasionally landed more orders than Boeing, but it has never beaten the American company on the number of aircraft actually rolling out of the hangar.



So poor is the outlook for Boeing that the company now admits that the launch of its cherished new high-speed jet, the Sonic Cruiser, announced with great fanfare a year ago as its riposte to Airbus's A380 super-jumbo, is likely to be delayed by up to two years. Mr Condit insists that the Sonic Cruiser will be launched only if enough customers want it.

If there is a silver lining, it is that Boeing's non-civil jet business now accounts for 40% of sales. This explains why its share price is more resilient than that of EADS, Airbus's parent company, which depends on civil business for 80% of its sales. The events of last year have therefore vindicated Boeing's diversification strategy, even if they have hurt some new businesses, such as a broadband-communications service that was to deliver live television and Internet access at 35,000 feet, but has only one customer, Lufthansa.

Boeing's biggest diversification has been the military business that it burst into when it bought McDonnell Douglas in 1997. This division suffered a blow late last year when it lost the $300 billion contract for America's Joint Strike Fighter to Lockheed Martin. Against that, it has some consolations: America's air force is expected to hand Boeing a contract to lease 100 converted 767 passenger jets as refuelling tankers. Airbus and European governments are crying foul at being excluded from bidding for the contract.

Boeing's biggest challenge is going to be maintaining profit margins in the passenger-jet business at much lower levels of production. To this end, it has introduced lean manufacturing techniques in its Seattle factories, even bringing in a moving conveyor line to streamline aircraft assembly. As margins come under pressure, especially in the civil business, Boeing can at least take heart from the fact that its factories now look (and, with luck, will perform) a bit less like giant garage workshops, and a bit more like modern manufacturing plants.

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Low-cost airlines

The pluck of the Irish

Jan 24th 2002 | FRANKFURT
From The Economist print edition

No-frills airlines are making Europe's national carriers twitchy

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DAVID, remember, killed Goliath with a single shot from his sling. If only Goliath had taken the youth to court first, as Germany's national airline, Lufthansa, is doing with Ryanair, a precocious Irish competitor.

O'Leary contemplates his battle plan

Ryanair lives on its cheapness, and often gives away seats by the thousand. Since 1999 it has been running no-frills flights between London and Hahn, 100km (60 miles) from Frankfurt, Lufthansa's hub. Ryanair has been luring bargain-hunters, helped perhaps by advertisements comparing its rock-bottom prices with the, ah, higher ones offered by Lufthansa. Ryanair now flies from Hahn to Shannon, in Ireland, and Glasgow; last November Michael O'Leary, the airline's boss, announced that it would start flying to several other European cities, including Milan and Oslo.

Lufthansa has accused Ryanair of unfair advertising, and has won several injunctions against the upstart in the German courts. One complaint is that Ryanair left some awkward details, such as taxes, out of its prices. Another is that the two use different airports to serve the same cities, and that Ryanair's are misleadingly far away. So for the time being Ryanair is not allowed to call Hahn “Frankfurt-Hahn”, even though that is what the International Air Transport Association calls it. That, says Ryanair, is as daft as denying that Heathrow, a fair jaunt from the centre of London, serves the British capital.

Ryanair has been hitting back, complaining to the European Commission and appealing in the German courts. A judge said on January 22nd that a decision was likely next month. Ryanair's passengers, however, probably care little what lawyers say. They get what they pay for, which is not much. There are no assigned seats, no free food or drink, and no transfers. If you have an onward flight, you must reclaim your baggage from the carousel and check in again for the onward journey. The cheapest seats, such as £10 ($14.40) one way from London to Hahn, have conditions attached.

Ryanair is not the only budget airline pricking the big boys. Germany's federal cartel office this week criticised Lufthansa for cutting prices too sharply—to below cost, it said—in a battle with Germania, a much smaller carrier, on the route between Berlin and Frankfurt proper. EasyJet, a British low-cost airline, is also building up its fleet and routes.

Unlike Ryanair, though, easyJet is aiming more at business than holiday fliers, and so would prefer to use more mainstream airports. That may be the harder strategy. EasyJet would like, for instance, to fly from Paris's Orly airport, where some slots may become available soon. Mais oui, say the bosses at Air France, the French answer to Lufthansa, but there could be new entrants other than easyJet. Hmm. A low-cost partner or subsidiary of Air France, perhaps?

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Hewlett-Packard and Compaq

Carly v Walter

Jan 24th 2002
From The Economist print edition

What the fight over Hewlett-Packard's future is really about

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AP

I'm not clueless, says Hewlett

THE battle over Hewlett-Packard's plan to buy Compaq, a rival computer maker, is becoming increasingly personal. HP's management, led by its chief executive, Carly Fiorina, has been trading blows with Walter Hewlett, a dissident board member whose father co-founded HP and who believes the merger is a big mistake. Assuming that the European Commission approves the deal—its ruling is expected by January 31st—shareholders will be asked to vote on it within the next few weeks. As the vote nears, things are getting nastier.

For weeks, HP has been running newspaper advertisements defending the merger, spiked with thinly veiled attacks on Mr Hewlett. He and the board have also exchanged fire in a series of letters to shareholders. On January 18th, in one such missive, the other members of HP's board derided Mr Hewlett as “an heir...a musician and academic...who has never worked at the company or been involved in its management”. HP has been developing this “clueless heir” theme for some time. The company says that Mr Hewlett missed one meeting because he was playing in a charity concert, and another because he was taking part in a bicycle race.

Behind the mud-slinging, however, this is not a personal disagreement at all. It is an argument over how best to respond to the commoditisation of computer hardware. Since all PCs are, in essence, interchangeable, whoever can build them most cheaply has the advantage. And as PCs become more capable, they are starting to commoditise the market for powerful server computers. Faced with eroding margins in hardware, what should HP do?

Mr Hewlett maintains that it should stick to its knitting—that is, areas in which it has a clear technological lead. The merger, he has said, “lacks strategic merit and substantially increases HP's exposure to the troubled commodity PC business”. Instead, he thinks HP should focus on what it does well—in particular, on its highly profitable printing and imaging business. He has the support of David Packard, who this week accused the board of twisting the words of his father, another co-founder, in an effort to force the merger through.

In contrast, Ms Fiorina sees greater scale in PCs, and a greater emphasis on services, as the best way to respond to commoditisation. Teaming up with Compaq, she insists, will enable HP to exploit economies of scale in PCs, and thus to compete more effectively with Dell, the nimblest computer maker. At the same time, the merger would strengthen HP's services arm, so that it can compete more vigorously with IBM.

Whose story is more credible? Mr Hewlett's supporters rightly observe that it will be difficult for a single company to compete against both Dell in the PC market and IBM in services. Furthermore, they say, getting big by buying a rival is not the “HP way”; the company should expand through innovation and organic growth, rather than acquisition. HP's board has attacked this position as a “status quo” strategy, and has accused Mr Hewlett of having “no plan to create value”.

Even so, neither vision of HP's future—as a smaller but more profitable company concentrating on printing and imaging, or as a larger, stronger company miraculously formed from the fusion of two weaklings—sounds terribly convincing. Is there a third way? Steve Milunovich, a veteran computer-

industry analyst at Merrill Lynch, believes there is. He supports the merger, not because he thinks it will be successful, but because abandoning it would be even worse for shareholders. That said, he is sceptical of Ms Fiorina's claim that the merged HP-Compaq will be able to be all things to all people. Instead, he suggests another way for the company to differentiate itself from its rivals—and to turn the trend towards commoditisation from a weakness into a strength.

The merged company, he proposes, “should position itself as the vendor taking PC economics to the enterprise”. This would involve arguing that PC technology is catching up with expensive proprietary servers sold by Sun, the leading server maker. HP-Compaq would then take on Sun directly, and sell servers based on Intel's chips and Microsoft's operating system as cheaper alternatives to Sun's products. Dell is pursuing a similar strategy, but has far less experience in the server market than either HP or Compaq. The merged company would also be able to sell services and storage equipment on the back of its servers.

Not everybody is convinced by this plan. Sceptics say it sounds very similar to the rationale behind Compaq's disastrous takeover of Digital Equipment in 1998. Mr Milunovich concedes this. But, he says, the Compaq-Digital deal was a good idea that was badly executed.

The discussion is probably academic, since few observers now expect the HP-Compaq merger to go through. In that case, Ms Fiorina would probably step down, and both companies would look seriously weakened. Some HP shareholders may conclude that they should therefore back the deal anyway. But that is not how Mr Hewlett's camp sees it. And given how difficult it would be to pull off a successful merger, perhaps a swift decapitation, leaving HP intact but without a chief executive, would be preferable to a botched merger that damaged the whole company.

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Face value

Kozlowski's colours

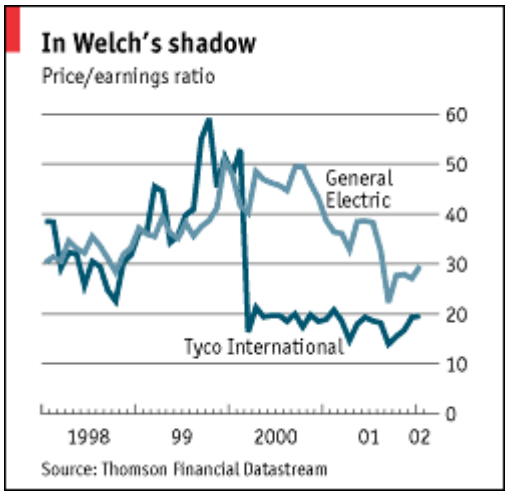
Jan 24th 2002
From The Economist print edition

Tyco's boss reacts to growing pressure by putting shareholders before empire

HIS admirers describe him as a rare business genius. But investors in Tyco International, Dennis Kozlowski's hyper-acquisitive conglomerate, have never quite bought this. As Tyco grew into a global empire with $36 billion of annual sales, its share price suddenly lost its zip. Mr Kozlowski had become frustrated, he told doubting shareholders at a meeting on January 22nd: “We are not getting paid for our results.” Amazingly, the man who had built the empire, buying more than 200 companies since becoming Tyco's boss in 1992, had decided to dismantle it and sell the pieces.

Mr Kozlowski is partly a victim of Wall Street caprice. People bought on stories alone during the long bull market of the 1990s. The bull market's end, together with the collapse of Enron, a Texan energy trader, has reawakened interest in the importance of counting your beans properly. Even Mr Kozlowski must admit that his 200 acquisitions have not made Tyco's accounts into easy reading. Worse, in 1999 the group's merger-accounting methods had been probed by the Securities and Exchange Commission (SEC), after David Tice, a fund manager, alleged that Tyco was booking inflated restructuring charges to pad profits in thin years.

The SEC took no important action. But the doubts lingered (see chart), and this year returned more forcefully than ever. Amid rumours of more accounting fiddles, Tyco's shares fell by almost a quarter in just three weeks. “We are strictly playing offence,” insisted Mr Kozlowski, a burly former college basketball player, about Tyco's break-up this week. But the big man looked hurt.



Mr Kozlowski grew up in a tough, inner-city Polish and Italian neighbourhood in Newark, New Jersey. Money was tight, and he worked to put himself through a Catholic university, where he studied accounting. He took his first job in the accounts department of SCM Corp, a high-flying but murky conglomerate that would later unravel. He joined Tyco, an obscure diversified manufacturer with $15m in sales, in 1976. He was later to become the company's auditor, but only really found his vocation when he crossed to the operating side.

As Wall Street drooled over new-economy industries, Mr Kozlowski dug into less glamorous work, buying struggling firms in businesses such as pipes and valves, water sprinklers, fire extinguishers, syringes and nappies. The faithful say he has made all this dull stuff sparkle.

First comes an invigorating shake-up. Mr Kozlowski and his in-house team of merger specialists toss out old managers and hand-pick their replacements. Mr Kozlowski looks for people like him—bare-knuckled, blue-collar fighters, immersed in the business and not the company bureaucracy. Tyco fires workers and closes factories without sentiment. Those who survive are paid to perform: even in America, Tyco's performance-related pay schemes have a reputation for generosity.

Mr Kozlowski's reputation is also built on his skill in fitting acquired businesses together, building scale in bitty markets. Like Jack Welch, the fomer boss of General Electric, Mr Kozlowski claims only to want the number one or two spot. Tyco's medical-products division leads, or is runner-up in, the American

markets for sutures, swabs, incontinence nappies and respiratory equipment. Tyco leads in fire-prevention and security systems. (It bought ADT, the leading American security company, in 1997.) In turn, Tyco's electronics-manufacturing businesses lead many of the markets that supply the hardware for fire and security services.

To this, Mr Kozlowski adds unusual energy and single-mindedness. He owns an aeroplane, a 130ft yacht (complete with marble fireplace) and three Harley-Davidson motorcycles, which he likes to ride helmetless. But he has little time for leisure. “Dennis is utterly, utterly committed,” says Robert Monks, a corporate-governance activist who sat on Tyco's board between 1985 and 1994.

The less impressed point to several other things. Tyco is registered offshore: its acquisition of ADT was structured as a reverse takeover, with the Bermuda-based company technically taking over Tyco, shifting the group's headquarters and its overseas profits beyond the reach of America's tax authorities. Tyco sells its debt via a Luxembourg-based subsidiary—another perfectly legal tax wheeze, but one that adds complexity. Tyco's accounts are unavoidably labyrinthine, but they are also frequently restated. As well as the restructuring charges that Mr Tice brought to investors' attention, others have questioned the write-downs that some of Mr Kozlowski's acquired companies have taken just before joining their accounts with Tyco's. Again, this could be a device to flatter future results. In the end, there is no real way for an outsider to know the truth: investors must put their faith in the audit.

Since they are now choosing not to, Mr Kozlowski has set about proving the doubters wrong using the only means left to him. Tyco is to be split into five pieces. The plastics businesses will be sold privately. Other bits will be sold to the public via initial public offerings. Mr Kozlowski himself will run the rump, which combines the security-systems unit with the electronics business. His new company will be less than half the size of the present Tyco—chagrin for a man who once said he wanted to run a $100 billion business by his 60th birthday, in 2006. His ruddy face is unlikely to grace the covers of America's business magazines for quite some time.

Mr Kozlowski can, however, take comfort from the fact that he will have done right by his shareholders, if he is correct in estimating that Tyco would be worth 50% more in bits than whole. Among his fans, his reputation has never been higher—although the stockmarket as a whole reacted coolly to his break-up plan. “The problem is, you can't control the music,” says Mr Monks. “The music changed, and Dennis knew when to stop.”

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About sponsorship

Commercial banks after Enron

Conflicts, conflicts everywhere

Jan 24th 2002 | NEW YORK
From The Economist print edition

Was America wrong to scrap the laws that kept commercial and investment banking apart?

Get article background

WHY did all the safeguards in American capitalism designed to stop fiascos such as Enron fail to do their job? One answer is that many of those institutions or individuals who could have blown the whistle faced conflicts of interest that may have compromised them. Dealing with these conflicts is likely to be a priority as politicians and regulators seek ways to prevent similar collapses.

One area of scrutiny will be the role of Enron's bankers, notably J.P. Morgan Chase and Citigroup. These two financial conglomerates exist in their current form, and provide the range of financial services they did to Enron, only because of the abolition of the Glass-Steagall act. This imposed statutory barriers between commercial banking, investment banking and insurance, and was introduced in 1933 following public protests about conflicts of interest on Wall Street in the aftermath of the 1929 stockmarket crash.

Rivals on Wall Street now whisper that conflicts of interest at these two banks may have played a role in Enron's collapse. Travelers (with its investment bank, Salomon Smith Barney) and Citibank merged in 1998, to form Citigroup. J.P. Morgan and Chase Manhattan merged in 2000. Since then the two have won market share in underwriting and advising on mergers and acquisitions from traditional investment banks, such as Goldman Sachs, Morgan Stanley and Merrill Lynch. They have done so in part by using their huge balance sheets to offer both loans and investment-banking services to clients.

Rivals complain that J.P. Morgan and Citigroup (as well as Bank of America and several foreign banks, such as Deutsche Bank and Switzerland's UBS) have made loans at a loss in order to win more lucrative investment-banking business. These banks, the rivals say, are able to avoid disclosing this, at least in the short term, thanks to favourable accounting rules that do not require commercial banks to mark their loan portfolios to market.

Might J.P. Morgan and Citi have let their lending standards slip in order to win investment-banking business from Enron, allowing the company to become over-leveraged? Did being both a creditor of Enron and an adviser create acute conflicts of interest as the company approached bankruptcy? As creditors, the banks may have had an interest in preserving whatever value Enron had left to maximise their chance of being repaid. As advisers, they may have had reason to promote riskier strategies in a bid to keep Enron alive and stop its shareholders being wiped out.

Both banks vehemently deny lowering lending standards to win investment-banking business. J.P. Morgan had lent to Enron for many years. The banks also deny that they took advantage of their advisory role by getting Enron to pay off unsecured loans to the company with money raised during a secured refinancing late last year.

Bring back Glass-Steagall?

Enron's collapse has, even so, triggered a new debate about whether it was wise to scrap Glass-Steagall. Even if it was not, more than the restoration of the old Glass-Steagall act would be needed to to put things right. Before its repeal, its force had been eroded by the Federal Reserve, which had allowed

commercial banks to edge into investment banking. Moreover, other conflicts of interest that were not prohibited by Glass-Steagall might warrant inclusion in a new law. A $100m settlement this week by CSFB, an investment bank, over its handling of initial public offerings suggests that the firm exploited its own customers. One end to conflict there would be to separate Wall Street's investment analysts from the underwriters of initial public offerings.

Yet does the existence of conflicts of interest really justify regulation or legal separation? Recent studies of Wall Street's behaviour before Glass-Steagall was passed suggest that most of the abuses meant to have arisen from conflicts of interest actually did not happen. Securities sold by firms that combined commercial and investment banking were not, by and large, of a lower quality than those sold by pure investment banks. Any firms that fell foul of conflicts of interest would lose customers. The argument for a legal separation of auditors and consultants is different: unlike financial advice or lending, audit is a quasi-public statutory function that merits maximum protection.

Most of the abuses meant to have arisen from conflicts of interest actually did not happen

Occasional blow-ups among banks provide an opportunity for market forces to show what behaviour is required. Charles Calomiris, an economist at Columbia University, reckons that Enron's failure is part of a pattern in financial innovation. The collapse of Penn Central in 1970 forced participants to improve governance of the market for commercial paper. Likewise, Enron will encourage better oversight of the growing number of companies with supposedly sophisticated financial hedging and trading. As for the banks that serve future Enrons, says Mr Calomiris, if any new regulation is needed it should be to ensure full and appropriate disclosure of information, not a return to Glass-Steagall.

There are already signs that market forces are addressing some other problems that arose after Glass-Steagall was abolished. Citigroup recently said that it will spin off Travelers, its property-casualty insurer, presumably because expected synergies with commercial and investment banking did not come about. “If we'd known that was going to happen when Citigroup was formed, Glass-Steagall might never have been scrapped,” says Ray Soifer, an independent analyst.

On balance, that would have been a pity. There is at least one positive message in Enron's collapse. Despite its big losses on loans to Enron, J.P. Morgan's survival is not in doubt—unlike American banks in past crises. The bank's revenues now come from a sufficiently diverse set of businesses that it can survive bad lending decisions with nothing worse than a damaged share price and bruised self-esteem. For America's banks, that is progress.

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J.P. Morgan Chase

Unsurety bonds

Jan 24th 2002
From The Economist print edition

For capital markets to work, everybody must be like Caesar's wife

THE reputation of J.P. Morgan Chase, already damaged by perceived conflicts of interest as a lender and work-out adviser to Enron, will be further hurt by an Enron-related battle in the courts. The spat also suggests that the long-heralded convergence of the insurance industry with wider financial services is still far off. In all, 11 insurance companies are refusing to pay Mahonia, an offshore entity based in Jersey, on surety bonds that they signed to guarantee Enron's performance on some oil-and-gas derivatives contracts. J.P. Morgan is acting for Mahonia, as it was behind the contracts.

The insurers argue that the derivatives contracts were misleading—that they were a cunningly disguised loan to Enron, and that the insurers did not know they were insuring a straightforward credit risk. J.P. Morgan says that even if they were a loan in disguise it would not matter: the surety bonds have been triggered by Enron's default and must be paid. In December J.P. Morgan asked a New York district court for a summary ruling that the bonds should be paid, but to no avail. This week the judge in a New York bankruptcy court ordered Enron to name witnesses and give more details of the transactions—exactly what J.P. Morgan did not want.

J.P. Morgan had gone to the insurance industry to buy a hedge against the credit risk of Enron, but when the crunch came it proved to be not a hedge but a nightmare. The bank had to add a potential $1.1 billion to its $620m unsecured exposure to Enron and raise its estimate of non-performing assets to $3.9 billion.

The lesson for banks is that insurance companies will wriggle and squirm before paying out on an insurance contract. If you want to nail them down you have to do it with a financial contract, such as a credit derivative, preferably under a document standardised by the International Swaps and Derivatives Association, the industry body. J.P. Morgan thought its surety bond contract had nailed them down, with such wording as “absolute and unconditional, irrespective of the value, validity or enforceability of the obligations of the principal.” It is taking a similar, long-running case, involving surety bonds relating to film finance, on appeal to Britain's House of Lords, so perhaps it should have been more wary. Only recently has it decided no longer to accept surety bonds to mitigate credit risk.

The insurance companies' defence for not paying up is that there is suspicion of fraudulent inducement. How do they know that these contracts or loans were not designed to hide part of the debt mountain at Enron and related companies? Reports about spivvy accounting practices and document-shredding arouse suspicion. Moreover, as one interested party points out, J.P. Morgan Chase is fighting another case in New York, in which Sumitomo Corporation alleges that the bank constructed forward copper contracts as loans: that allowed a rogue trader at Sumitomo, Yasuo Hamanaka, to keep on trading in the early 1990s, to his company's great loss. J.P. Morgan failed in October to get the case dismissed.

Whatever the rights and wrongs of the latest case, it is clear that J.P. Morgan did not design a robust financial instrument to hedge its credit exposure to Enron. It is intriguing that a bank which has made risk management central to its reputation could lay itself so wide open to legal risk.

Has this also damaged the reputation of insurers as financial risk-takers? Rajeev Misra, head of credit trading at Deutsche Bank, thinks not. The last two years have seen billions of dollars of credit derivatives traded with insurance companies, he says. They are natural providers of risk capital and it is good business for them. Still, the language of the contracts has to be carefully studied, Mr Misra suggests, so that a genuine transfer of risk takes place. Insurance companies enjoy special protection on insurance contracts, under British and American law, against fraudulent inducement to insure.

Is nothing sacred? Alas, even letters of credit can let you down. J.P. Morgan is fighting yet another case in New York, against Westdeutsche Landesbank and others who refused to pay up on a $165m letter of credit guaranteeing Enron's performance on gas swaps with Mahonia. Same bankruptcy court, same suspicions: that it was a loan, possibly a fraudulent one, not contracts to deliver gas, and that more information is needed before the parties pony up. Oh for the days when capital markets worked smoothly—and when J.P. Morgan was above suspicion.

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Audit scandals

Enron and on

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It only gets worse

THE fallout continues. Kenneth Lay, chairman and chief executive of Enron, resigned, saying that multiple investigations into the company's collapse were taking up all his time. Disgruntled ex-employees now suggest that crucial documents at Enron concerning the partnerships that hid huge liabilities were shredded, and that the shredding went on even after the Securities and Exchange Commission (SEC) had launched a formal investigation. Previously, document-shredding was known only to have happened at Andersen, Enron's auditors.

Enron executives stress the repeated orders to employees to err on the side of caution when destroying documents. And on January 17th they put distance between the company and its auditors, by firing Andersen. The auditors, in turn, had canned David Duncan, in charge of the Enron account, but faced scrutiny for the frequent presence in Houston of an in-house lawyer, Nancy Temple, as the shredding was going on. Mr Duncan told investigators on Capitol Hill that far from acting alone, he was in constant communication with Andersen's Chicago headquarters. Andersen's boss, Joseph Berardino, took his charm to the talk shows, which congressional committees who wanted to interrogate him first resented.

The entire auditing industry is under a cloud, for its perceived conflicts. Harvey Pitt, chairman of the Securities and Exchange Commission (SEC) and before that a lawyer for all the big auditors, told *Barron's* on January 7th that “there is nothing rotten in the accounting profession.” Mr Pitt has avoided a harsh stand; at the time, he opposed his predecessor's efforts to bar auditors from providing consulting services to their audit clients. On January 17th, he proposed a new regulatory body to oversee accountants, but had the idea thrown back in his face. The proposal was vague and toothless, some said: it was unveiled after weeks of private meetings with executives from the major accounting firms and the industry trade group.

One lot mortified at not being consulted were the five wizened executives from outside the accounting profession who make up the Public Oversight Board, created by the SEC to oversee accounting ethics. Mr Pitt's proposals, the board's chairman, Charles Bowsher, said, will only make things worse. The board voted to disband itself.

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Andersen

Wisdom mislaid

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Seduced by Enron, the accounting firm forgot rules it once urged on clients

Get article background

WITH the fanfare of a press release and an accompanying graphic, Arthur Andersen announced its “Ten Commandments of Risk Management”. Based on “investigative work on behalf of regulatory and institutional clients”, the commandments were designed to “capture, in a few memorable words, the sometimes densely argued, lengthy reports on risk-management failures”. Managers were reminded to keep the commandments clearly in focus. The date was July 1997.

Imagine if Andersen auditors on the Enron account had remembered the first commandment. “Understand your profits,” it runs. “Large profits you don't understand are more dangerous than large losses you do.” Or the seventh commandment, to “track the cash. Accounting entries can be manipulated; cash disbursements cannot. Cash is the fundamental control.” Sadly, Andersen also forgot the eighth commandment, to “respect business quality. Volume is no substitute for value.” Even the wisest can fall prey to false idols. Enron was Andersen's golden calf.

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Japanese bond funds

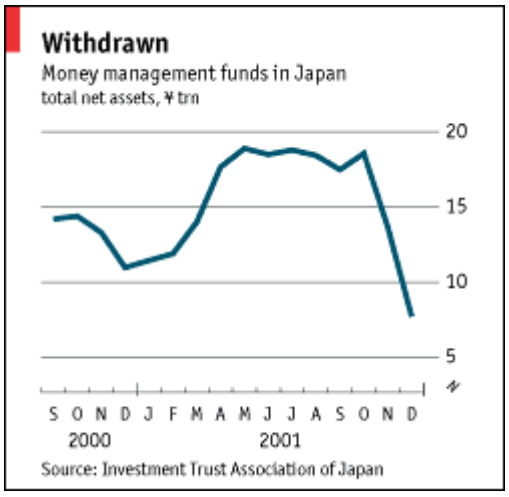
Stuffed

Jan 24th 2002 | TOKYO
From The Economist print edition

How Enron and Argentina have unsettled Japanese investors

FOR Japan's money-management industry, the collapse of Enron was little short of catastrophic. Five money-management funds that held bonds issued by the Texan energy-trader fell below their face value, sparking a panic-driven run on these and other funds. In just two months, this once vast industry has lost some ¥10.8 trillion ($80.6 billion), or almost 60% of its assets (see chart).

Money-management funds, which invest mainly in short-dated corporate bonds and commercial paper, had been marketed as extremely safe, yet slightly more lucrative, alternatives to bank deposits, which currently yield next to nothing. In most rich countries, the marketing would be accurate. And in Japan, before the Enron fiasco, investors poured into the funds. With the government due to lift its blanket guarantee on bank deposits in April, brokers had hoped to attract even more money this year.



Instead, they are struggling to save the industry's reputation. It turned out there were no regulations over how money-management funds were sold or run. Unlike other types of bond funds, credit-rating or maturity restrictions did not apply. Nor were there limits on how much of a single issuer's debt a money-management fund might hold.

On January 18th the Investment Trust Association of Japan, the industry body, came up with a rushed set of investment rules. Among other things, the new rules urge fund managers to protect retail investors by setting limits on how much money corporate investors may withdraw on any day; the rules also improve disclosure. Slow to sniff trouble at Enron, retail investors suffered when fund managers sold liquid assets to finance withdrawals from better-informed institutional investors, leaving individuals stuck with mostly illiquid paper.

The industry has had plenty of chances to improve the safety of money-management funds. One came last year, when a fund run by Meiji Dresdner Asset Management fell below its face value after Mycal, a retailer, collapsed, defaulting on ¥350 billion of bonds. Although Mycal's credit rating had fallen sharply, fund managers at Meiji Dresdner, believing that creditor banks would bail out the retailer, had failed to reduce their Mycal holdings.

Although the new rules will stop managers from taking such gambles, their funds are still risky. When interest rates were higher, fund managers could offset bond losses with coupon payments from higher-yielding bonds. But with interest rates close to zero, higher yields are just a memory. Retail investors are learning the hard way that, even after Enron, there are plenty of other potential defaulters. Over 30,000 investors have been left holding a chunk of the ¥190 billion of yen-denominated Samurai bonds issued by Argentina, which has also defaulted on its debt.

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Russian finance

Load it up

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Bad banks mean good times for Russian bonds

NO BANKS plus lots of liquidity equals a thriving bond market. That is the new equation in Russian finance, as cash-rich companies start putting their roubles into corporate bonds, thus providing money for companies wanting to invest. In a more developed economy, that would also be the banks' job. In Russia the banks are puny, badly regulated, and plagued by state interference. Loans are scarce and expensive, collateral hard to nail down. That makes bonds the alternative.

After Russia's spectacular default and devaluation in 1998, the idea that local financial markets might recover seemed wildly optimistic. But it has happened. The main reason is that Russian companies, especially those dealing with energy and raw materials, are making more money, and also managing it more sensibly. Instead of shunting the loot offshore as fast as possible, managers are increasingly investing it legally inside the country. They put some straight back into their own or a friend's business. The rest is looking for a more sophisticated home.

The results are noticeable. Six months ago, a typical rouble corporate bond would have raised a mere $30m, with a six-month maturity. Now banks are working on $100m issues with terms of 18 months. Last year, the whole market for corporate bonds was only a couple of billion dollars. Renaissance Capital, a Moscow-based investment bank, expects it to be five times that in a year or two.

Not that foreigners are rushing in. Even the most solid Russian borrower, a mobile-phone outfit, has merely a B-plus credit rating. Most score a lot less. Worse, there is no easy way of hedging the currency risk, thanks to an infamous Russian court ruling in 1998, which deemed that forwards were not contracts, but unenforceable bets. Nonetheless, the yields look attractive, and some banks are planning derivative instruments to attract steely-nerved outsiders.

Russian equities are also doing well, with the main index nearly doubling in the past 12 months. Still, Russian companies show little sign of wanting to raise money via new share issues. Volumes are low and risks high. The market is tiny: the capitalisation of the whole Russian exchange is only twice that of stricken Argentina's. Moreover, negative real interest rates have given the shares an artificial fillip. If the central bank sorted out its monetary policy, stocks would look less attractive, and bonds more so.

Russian companies are also raising money abroad. This week two Russian banks announced plans for Eurobond issues worth $100m each. A sprawling juice and dairy outfit called Wim-Bill-Dann (named after its founders' fondness for the Wimbledon tennis championship) is planning to list on the New York Stock Exchange later this year—only the third Russian company to do so.

The big question for the Russian economy is whether a bouncier and more sophisticated financial market heralds a real turnaround in industry. There is certainly a lot of shuffling of assets going on, often behind the scenes. Metals companies, for example, are buying everything from car factories to agricultural businesses. But for the most part it is still hard to see the quality of management improving. Productivity remains low, investment is often wasteful or misdirected, products are clunky. Skills such as cost-control and brand management are still lacking, and political ties are more important than brains or hard work.

The best that can be said at this stage is that at least the price of bad management is rising. “The market has been unleashed and these fuckers cannot hide from it,'' says a top western banker. Russia's industrial assets are also increasingly held in more-or-less coherent chunks, which real owners may then be able to sell to outsiders who can manage the businesses properly. When and if that happens, Russia's corporate financiers will really have something to celebrate.

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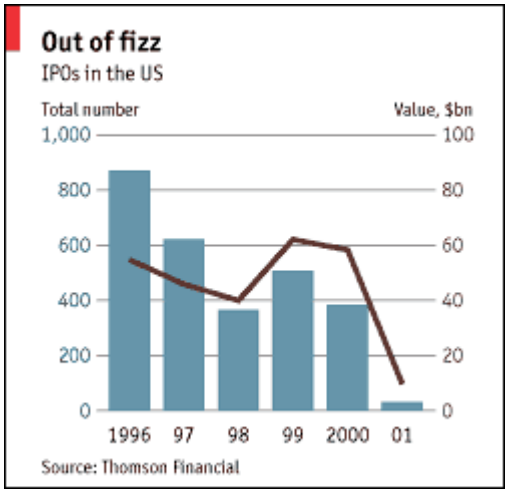
CSFB fined

That was then

Jan 24th 2002 | NEW YORK
From The Economist print edition

CSFB settles allegations of bilking customers



ON JANUARY 22nd Credit Suisse First Boston (CSFB) sued for peace with the Securities and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD). They had been investigating the investment bank's abusive practices when allocating shares in initial public offerings at the height of America's bull market in 1999 and 2000. CSFB agreed to pay a $30m fine and to pay back to the government and to the NASD (though, tellingly, not to investors) $70m of supposedly ill-gotten gains. It promised to behave itself in future.

Investigations continue into eight other banks, including J.P. Morgan Chase, Morgan Stanley and Goldman Sachs. CSFB's settlement covers only the firm itself, not its employees. Senior executives at the firm “knew” and “encouraged” wrongful conduct, the SEC says, thus leaving the impression that some individuals at CSFB might yet be pursued. Three brokers at the firm were fired last June, and CSFB says that more are being disciplined with suspensions and fines. On the other hand, the firm vigorously defends Frank Quattrone, the head of CSFB's technology underwriting group, whom the media had tried to implicate.

Punishment-lite

The settlement underscores just how lucrative were initial public offerings. Typically, a bank earns on average six cents a share for brokering an ordinary trade. For public offerings at their height, commissions amounted to as much as $3.15 a share. Intricate schemes forced clients who received allocations of hot deals to pay additional commissions, by buying and selling other stocks that they never had any intention of keeping. This way, CSFB got up to two-thirds of the profits to be had from the explosive initial rise of popular offerings, such as those for VA Linux, Fog Dog and MP3.com. In one quarter of 1999, these inflated commissions accounted for over one-fifth of the firm's total commission revenue.

In reaching an agreement, John Mack, hired as CSFB's chief executive last year, is hoping to bring to a close a chapter that played a part in the sacking of his predecessor, Allen Wheat. The SEC penalty is big—second only to $120m paid by Salomon Brothers in 1992, for violating rules governing the sale of American government bonds—yet CSFB has got off lightly, all the same.

The violations cited by the commission and the NASD are more technical than criminal. The firm is faulted for describing all payments for public offerings as trading commissions. Missing are more serious allegations of fraud or of market manipulation such as laddering—using agreements with buyers to push up the value of shares in the hours and days after an initial distribution. No disclosure violations are cited. And no victims have been formally identified. CSFB is now in better shape to withstand its greatest impending legal threat: the hundreds of civil suits that have been filed.

It is certainly hard to think of the hedge funds and wealthy individuals who paid the bulk of the high commissions to CSFB as real victims. They could best satisfy CSFB's demands by selling their allocation after the initial rise in share prices. That, with hindsight, spared them many shares' subsequent collapse. According to Jay Ritter, at the University of Florida, some 99% of all initial public offerings of Internet companies in 1999 and 2000 are now below the share price at which they closed on their first day of

trading. Some 97% are below their offer price, and half have been delisted or trade at under $1 a share, including Fog Dog and MP3.Com. VA Linux, whose shares went public at $30 and closed on the first day at nearly $240, now trades for under $3. The real victims, poor things, were people who bought in the aftermarket, only to see prices collapse.

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The European Central Bank

Faites vos jeux

Jan 24th 2002 | FRANKFURT
From The Economist print edition

In search of a new vice-president

AP

Look what I wrote, Christian

A ROUTINE letter, says the European Central Bank. Maybe, say those who watch the ECB. But a reminder, still, about the fun in the next few months, with luck at the expense of some very important Frenchmen.

The letter is indeed routine. The president of the ECB, Wim Duisenberg, has written to the EU Council of Ministers to remind them that next May the office of vice-president falls vacant. The term of the current incumbent, Christian Noyer, who is French, expires. A swift decision on a replacement, if you please, would be in the best interests of the bank.

France's president, Jacques Chirac, once expected that by next spring Mr Duisenberg himself would be standing down. That is what Mr Chirac thought was agreed with the Dutchman in 1998. When he departed, Jean-Claude Trichet, governor of the Bank of France and Mr Chirac's candidate, would take the top job. Yet Mr Duisenberg is not budging. He denies ever naming a date for his departure. He has always said he is unlikely to serve his full term, which expires in 2006, when he will be 71, but he recently added that a change at the helm this year would be unwise.

A straight French replacement for Mr Noyer, then? Probably not. The rules do not seem to allow a move from there to the top job. So put Mr Trichet on the ECB's six-member board, and shift another board member into the vice-president's job? A snag: Mr Trichet is under investigation over his relations with Crédit Lyonnais, a bank with a patchy past. Yet it seems inconceivable no Frenchman at all should sit on the board—and just before the French elections, at that.

Who else for the top job? No obvious alternative in France. Of the ECB board, Otmar Issing, a good economist, would be a fine choice. So would Tommaso Padoa-Schioppa, an outstanding central banker. Yet politically, both may be ineligible. Mr Padoa-Schioppa, as an Italian, would be unacceptable to the Germans; and Mr Issing, as a German, would be unacceptable to everybody else.

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Economics focus

Plus ça change

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The lessons of sound money from 1,000 years' experience

THIS month has seen progress in one bold monetary experiment, the issuance of euro notes and coins, and the failure of another, Argentina's currency board. In the history of money, this is all par for the course. Currencies, and systems for managing them, have come and gone with striking frequency ever since Croesus, king of Lydia, first minted coins in the sixth century BC.

Might the euro also fail? A new book, "The Big Problem of Small Change"*, underscores how little has been learnt from more than a millennium of monetary experiment. This fascinating new history of money shows that the key ingredients of a sound currency were identified in Europe hundreds of years ago. The mystery is why, even today, so many governments fail to put this knowledge to work.

The authors, Thomas Sargent of the Hoover Institution and François Velde of the Federal Reserve Bank of Chicago, argue that today's monetary orthodoxy has its origins in an ancient puzzle. For several centuries after 1200, when Charlemagne's famous silver penny was supplemented throughout Europe with coins of other denominations, there were inexplicable shortages of small change, which curiously coincided with a fall in their value, apparently defying the laws of supply and demand. Why?

Most of the value of a coin derived from the amount of precious metal in it. The amount by which the value of a coin could vary had an upper and lower limit. One reflected the cost of turning, say, an ounce of silver into a coin (this included minting costs plus a government coinage tax known as seigniorage). The other was what could be bought if the coin were melted down and the metal it contained used as payment. The supply of each denomination depended on how much silver people took to the mint.

A shortage might occur because of an unexpected rise in national income or its distribution, causing ordinary people to increase their purchases of bread, beer and so on. Small coins, not big ones, were needed for these transactions, which would often be for far less than the denomination of a high-value coin. At the same time, the value of small coins relative to big coins would often fall.

The authors explain this using modern monetary theory—which, alas, is somewhat counter-intuitive. Broadly, instead of using simple supply and demand, it explains changes in the demand for one asset (a small silver coin, say) relative to another (a large coin) in terms of changes in the rate of return that the holder of the assets can expect from each. Depreciating smaller-denomination coins—which lowered the expected return from holding them—was the market's way to encourage holders of money to ease the shortage by getting rid of their small coins, the authors reckon. But this often made things worse, because the depreciation took the value of small coins below the point at which it paid to melt them down.

For centuries governments responded to a shortage of small coins by debasing them, ie, reducing the amount of silver required to make a penny. This provided an incentive for people to turn silver into pennies, but it generated inflation.

Eventually an ingenious way was found out of the mess. Instead of each denomination containing precious metal, only one higher-denomination coin would do so. All other denominations would be tokens, made of a metal too cheap to be worth melting down, that could be exchanged for higher-denomination ones (or for a set amount of the precious metal) at a rate fixed and guaranteed by the government.

Following the invention of the Boulton steam press in 1787—which raised the cost of forgery—a British

token currency flourished, initially issued by private firms before being nationalised in 1816. By the late 19th century, most other leading countries had token currencies, mostly pegged to the value of gold. Hence the rise of the gold standard.

A question is left unanswered. If the problem of small change led economists to understand how to run a system of token money, did some of the greatest economists of the early 20th century learn the wrong lesson from the system's success? John Maynard Keynes and Irving Fisher, among others, opposed the gold standard as a waste of valuable resources. They argued for a currency based entirely on tokens, with no link to an underlying physical commodity. Governments, greedy to spend their gold reserves, warmed to this idea, particularly during the 1930s depression. When America belatedly and finally abandoned the gold standard in 1971, it was history.

Abandoning the link to gold meant that it was entirely up to governments to ensure that their token-based currencies kept their value. In the event, for most of the 20th century they failed. They presided over levels of inflation that were seldom seen when money was backed by precious metal, debasement notwithstanding. Does history teach that a token-based currency works only if it is anchored to some unambiguous real store of value that a government cannot inflate away? Ironically, this was the logic behind Argentina's currency board, anchored to the American dollar rather than to gold. In the end, Mr Sargent says, that failed in part because even anchored systems cannot co-exist with unsustainable government debts, as in Argentina; the temptation to reduce debts by tampering with the value of money is too great. Even economic insights developed over hundreds of years cannot work their magic without the requisite political will.

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* “The Big Problem of Small Change”, by Thomas Sargent and François Velde. Princeton University Press, 2002.

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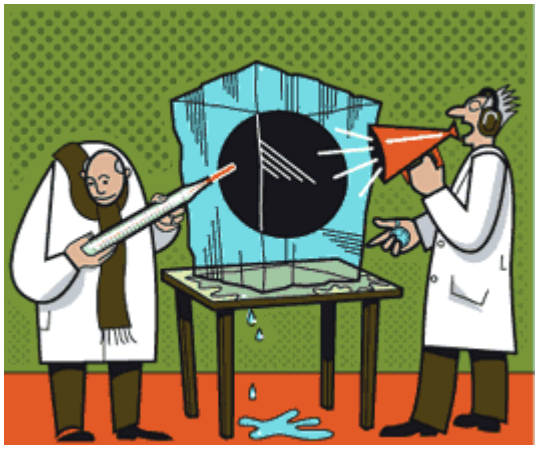
Artificial black holes

Hearts of darkness

Jan 24th 2002
From The Economist print edition

Models of the densest things in the universe may soon be made in the laboratory



OBJECTS enter its confines and are never seen again. Nothing, not even information, can escape from it. Only through complicated manipulations of logic can the mechanics of its operation be understood or even speculated about.

For many people, this would serve as a good description of their office desks. But it is also a description of a black hole. So news that physicists are trying to combine the two, and construct a black hole on a desktop, might seem rather like news that biologists are trying to gild the lily.

Yet a black hole that could be poked and prodded would be helpful for more than mere excuses for lost paperwork. It might allow physicists to test theories of quantum gravity, the elusive link between Einstein's theory of relativity and the laws of quantum mechanics. Researchers are thus keen to find things that resemble black holes closely enough to be interesting, but not enough to be catastrophic.

Cool results

Physicists believe that black holes form when heavy stars collapse in on themselves, producing points with a gravitational attraction so strong that nothing, not even light, can escape their pull. At the boundary of a black hole—the so-called event horizon—light slows and stretches out, while time draws to a standstill, as predicted by the theory of relativity. People realised that black holes had interesting quantum-mechanical features as well as relativistic ones when Stephen Hawking, a theoretician at Cambridge University, pointed out that black holes should not be black at all. Instead, they should glow.

The reason for this is that according to Heisenberg's uncertainty principle, an important tenet of quantum mechanics, “empty” space is not entirely empty. At the quantum scale, “virtual” pairs consisting of a particle and its antimatter equivalent are constantly popping into existence. Normally, they pop back out again in very short order, but a black hole can peel such pairs apart by sucking either the particle or the antiparticle in. Bereft of its partner, the survivor cannot vanish again, and so becomes real. The energy required to give it reality is drawn from the black hole. Unfortunately, this phenomenon, dubbed “Hawking radiation”, is so weak that it would be obscured by background radiation left over from the Big Bang. At least, that is how physicists explain the fact that it has never been detected.

This is where the desktops come in. According to Ulf Leonhardt, a physicist at the University of St Andrews, in Scotland, light passing through a cold goo of atoms known as a Bose-Einstein condensate ought to behave like a black hole—even producing radiation similar to that predicted by Dr Hawking. Bose-Einstein condensates can now be rustled up in any self-respecting laboratory that has the apparatus necessary to cool things down to within a few zillionths of a degree of absolute zero, so this theory should be testable.

According to quantum mechanics, atoms, like all other objects in the universe, can be thought of as waves as well as particles. When they are cooled sufficiently, these waves tend to spread out and overlap with one another, merging to form a single object—in other words, a Bose-Einstein condensate. Using lasers, it is possible to control the transparency of such a condensate and make it hard for light of a

certain wavelength to get through. Light can even be brought to a standstill in such a medium.

Dr Leonhardt argues, in this week's *Nature*, that the boundary where the light has stopped will resemble the event horizon of a black hole if the pulse of light travelling through the condensate is tuned to take the shape of a type of curve known as a parabola. The tip of the parabola will, mathematically, be a singularity. Light of certain frequencies will not be able to escape this apex. Meanwhile, if Dr Hawking is correct, pairs of photons (the particles of light) will be generated on either side of the apex just as they would at a black hole's event horizon. They might even appear at a high enough rate to be perceptible to the naked eye.

Perfect silence

Dr Leonhardt's artificial black hole is a nice idea, but it would be able to trap only certain frequencies of light, whereas a real black hole guzzles up light of all stripes. A more omnivorous type of mock black hole was suggested about 20 years ago by William Unruh, of the University of British Columbia. He pointed out that sound waves in a stream of fluid that was, itself, travelling supersonically would be trapped inside the stream. That stream would thus be the acoustic equivalent of a black hole—a “dumb hole”, as he dubbed it. As a result, an acoustic version of Hawking radiation ought to occur at the dumb hole's boundary. This radiation would take the form of packets of sound waves called phonons.

A third analogy to black holes may be provided by a type of helium known as ^{3}He. When this substance is cooled to very low temperatures, it flows without friction. Four years ago Grigori Volovik, of the Landau Institute for Theoretical Physics in Moscow, and Ted Jacobson, of the University of Maryland, proposed that this “superfluid” could be coaxed to behave like a black hole by introducing different sorts of texture into it. For example, a special type of wave known as a soliton could behave like an event horizon as it passed through ^{3}He. The soliton would trap things known as quasiparticles within its confines, and radiate, in a Hawking-like manner, further quasiparticles. A quasiparticle is, as its name suggests, not exactly real. But it is real enough to be detectable—it is a stable excitation state of some of the atoms in the helium that behaves enough like a pukka particle to be detected like one.

At the moment, all three of these ideas remain just that: ideas. But for the first physicist who can make one of them tangible, and demonstrate that the Hawking radiation does actually exist, the sought-after trip to Stockholm, to collect a Nobel prize, would surely follow. It would also be a vindication of Dr Hawking who has, in defiance of the muscle-wasting disease from which he suffers, just celebrated his 60th birthday. So far, his theories of the universe have tended to remain untested. It would be a delicious irony if proof positive of one of them came from an apparatus built on the top of a desk.

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Cocaine addiction

Having it all

Jan 24th 2002
From The Economist print edition

Experiments on monkeys suggest drug use is linked to social status

BIOLOGISTS are often accused of taking a rigidly deterministic approach to behaviour. Often this is in the context of reports of a “gene for this” or a “gene for that”. One example is the idea of an addictive personality, which some people have tried to link to versions of particular genes whose products are found in the brain. But genes do not act in isolation from the environment. Rather, genes and environments are locked together in complex loops that feed back on each other.

A report in *Nature Neuroscience* illustrates this. Michael Nader and his colleagues at Wake Forest University, in Winston-Salem, North Carolina, have been investigating cocaine addiction in macaque monkeys, with a view to testing out ideas about the drug's effects on people. They wanted to examine whether there was any relationship between an animal's social status and its tendency to get hooked. Is addiction the prerogative of the monkey equivalent of the executive washroom, the ghetto crack den, or both?

As the addictive-personality model would predict, there was indeed a difference between the addictive propensities of individuals. It seemed to be linked to the activity of a specific protein derived from a specific gene. However, the cause of the difference was not, as the naive determinist might have supposed, genetic. It was, rather, environmental.

Cocaine belongs to a class of drugs known as dopamine re-uptake inhibitors. Dopamine is one of the chemical messengers, known as neurotransmitters, that allow signals to jump the gaps between nerve cells. The electrical impulses that conduct signals along nerve filaments stimulate the release of neurotransmitter molecules when they reach the end of a filament. Those molecules are picked up by specialised receptor proteins on the surface of a cell on the other side of the gap, and the binding between neurotransmitter and receptor triggers a sequence of events that sets off an electrical impulse in the second nerve cell. The receptor then lets go of the neurotransmitter.

In some cases, when the neurotransmitter has done its job, it is sucked back into the cell whence it came, by a process known as re-uptake. Dopamine is one of these cases. So a molecule that blocks the protein channels through which re-uptake happens means that dopamine hangs around in the gap, and can re-stimulate the cell on the other side. Since the parts of the brain that control mood often rely on dopamine-mediated nerve cells, dopamine re-uptake inhibitors can have a profound effect on mood, which is why some people are willing to spend large amounts of money buying cocaine.

Monkeys like cocaine too, and for much the same reasons. But, unlike people, they can be experimented on. Dr Nader and his colleagues were particularly interested in the relation between a monkey's position in a group's dominance hierarchy, how addicted it was to cocaine, and the activity of a dopamine receptor protein called D2.

The experiment began with 20 male monkeys, which were housed individually for 18 months. During this time, their D2 activity was measured using a brain-scanning technique called positron-emission tomography (PET). Positrons are the antimatter equivalent of electrons, and are produced in a rare type of radioactive decay. PET works by introducing biologically active molecules containing positron-emitting atoms into the tissue to be studied, and seeing where the chemical concentrates by watching the effects of the positrons. Dr Nader's group used a substance that has an affinity for D2 receptors and thus accumulates in tissues where they are found.

Once their time in individual cages was over, the monkeys were housed in groups of four. Animals in such groups quickly establish who is in and who is out. Based on earlier work, Dr Nader suspected that

such dominance and subordination would reflect D2 activity, and it did—but not in the way that genetic determinists might have predicted. Dominant animals had more D2 activity than subordinates, but that was a consequence of their dominance, and not its cause. Regardless of their D2 activity when kept individually, monkeys that became subordinate showed little change in their PET responses after they had been put into company. In the animals that became dominant, by contrast, D2 activity increased significantly.

The other thing that Dr Nader did with his experimental subjects was to introduce them to cocaine. They were able to obtain the drug by pressing a lever. They could thus control their own intake.

Like D2 activity, cocaine use was related to social status. Dominant animals found a preferred level, then stuck to it. Subordinates, though, seemed to need bigger and bigger fixes as time went on. That is a classic symptom of addiction—and it may well be linked directly to D2 activity.

This is because the overstimulation that cocaine causes makes the body behave as though too much of the neurotransmitter is being churned out. Production of dopamine drops in response, so that when the cocaine goes away, too little stimulation takes place. The quickest way to restore the situation is to take more cocaine—in other words, to be addicted.

Individuals with a higher baseline of D2 activity might be expected to be less susceptible to this process, since the relative overstimulation caused by a given dose of the drug will be smaller. So dominants, which have more D2 activity as a result of their status, are less likely to become addicts. Propensity to addiction, in other words, is not a predisposition of the individual, but the result of social context.

If these results translate to human experience, they will be a sad example of the biblical adage that unto everyone that hath shall be given; but from him that hath not, shall be taken away even that which he hath. Not only are those at the bottom of the heap more likely to be convicted and locked up for using drugs than those at the top (which they are), they are more likely to have to carry on using them, once they have started.

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South Africa's oceanic squabble

Cape crusaders

Jan 24th 2002 | CAPE AGULHAS
From The Economist print edition

Finding where two oceans meet is not as simple as you might think

A FEW minutes' drive north of Quito, Ecuador's capital, travellers flock to a painted yellow line that marks the equator. At the Greenwich observatory in London, visitors can place a foot in each of the eastern and western hemispheres by straddling the Greenwich meridian. And at South Africa's Cape Point tourists see the Atlantic and Indian oceans splash together. Right? Not the third of these. Over 800,000 people each year trek to the spectacular cliffs, the lighthouses and Two Oceans curio shops at Cape Point, an hour from Cape Town, believing they witness the seas meeting. They are tricked, and the shops trade under false pretences, say huffy residents of Cape Agulhas, over 100km farther east. The chilly Atlantic and tropical Indian oceans really come together, they claim, at their own little-known spot—a flat, scrubby outcrop of rocks well off the tourist track.

It is not easy to judge where one ocean ends and another begins. One way is to study what lives in the water and how warm it is. The Atlantic coast is chilly and popular with penguins, seals and male sharks; the tropical Indian Ocean gets human swimmers and some pregnant female sharks, as both prefer warm water. So where the temperature changes, just to the east of Cape Point, in False Bay, could mark where the oceans meet. Wrong, argues Riaan Pienaar, a campaigner from Cape Agulhas. False Bay—note its dubious name—is shallow and sheltered and will always be warmer than the open sea. Instead, he says, if you study the currents of the oceans, you can argue that they meet more often at Cape Agulhas than anywhere else. Not convinced? Then look at kelp, a type of seaweed that likes cold water and grows beyond Cape Point right up to Cape Agulhas—but no farther.

This is all probably just fishermen's tales. Oceans exchange water all the time and there is never a neat dividing line, says Howard Waldron, an oceanographer at the University of Cape Town. The warm Agulhas current from the Indian Ocean, for example, washes into the Atlantic, causing eddies and swirls as far away as Brazil. The western, Atlantic, coast of South Africa is colder than the eastern one, he says, only because of currents that suck cold water up from the deep and wash it onshore.

So who is right? Oceans are divided by man, not by nature, and 50 years ago the International Hydrographic Organisation drew a line, at 20° East, from the Antarctic to Africa, to do so. That line comes ashore beside Africa's second-oldest lighthouse, at the continent's most southerly tip, Cape Agulhas. It is marked with a small plaque, as shown in our picture. Mr Pienaar is now petitioning South Africa's government to tell Cape Point shops to drop the Two Oceans slogan, and for guide books, the national tourism board and others to get their facts right. The Agulhas tourist board mutters darkly of taking Cape Point retailers to court. It wants Agulhas on the tourist map, so the town can attract more than the 40,000 or so visitors it gets each year. That is not much to ask for such an important, if windswept, place.

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The Richard Casement internship

Jan 24th 2002
From The Economist print edition

We invite applications for the 2002 Richard Casement internship. This is for a would-be journalist under 25 to spend three months of the summer on the newspaper, in London, writing about science and technology. Our aim is more to discover writing talent in a science student than scientific aptitude in a budding journalist. Applicants should write a letter introducing themselves, along with an original article of about 600 words which they think could appear in the Science and technology section. They should be prepared to come for an interview in London or New York, this March, at their own expense. Applications must reach us by February 22nd and should be e-mailed to casement@economist.com.

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Classical music in Moscow

The complex costs of artistic liberty

Jan 24th 2002 | MOSCOW
From The Economist print edition

Within the peeling confines of a former princely mansion in the heart of the Russian capital, a celebrated musical academy is struggling with change

AS MUSICIANS say, let us take it from the top. The management scandals and monetary heartaches at the Moscow Conservatory, one of the musical world's finest classical academies, would make a hilarious comic opera if they were not so serious. And they would not be so serious if a tradition were not at stake. Tchaikovsky taught composition here. Scriabin and Rachmaninov graduated with coveted gold medals. In the piano school, the great Neuhaus taught Richter and Gilels. If commitment to music and institutional pride were all it took, the conservatory's future would be assured. Alas, the story is not that simple. There is a problem of management and a problem of teaching, and both come down to hard questions of cash.

After a distressing period of drift and rumour in the 1990s, Mikhail Ovichinnikov was removed as rector in October 2000 for grave infringements of financial discipline. A new head, Alexander Sokolov, was soon elected, unanimously, and approved by the Ministry of Culture, which is ultimately responsible for the conservatory and its famous school.

Mr Sokolov, who has won wide respect, at once set about trying to stabilise the conservatory's finances and raise the school's pitiful teaching salaries. Mr Ovichinnikov, meanwhile, sued for wrongful dismissal on a technicality, and won. In December, a Moscow court ordered the minister of culture to pay him 14 months' back salary and reinstate him in a senior position. The minister reluctantly obliged—and asked the Russian federal prosecutor to continue with criminal proceedings against him.

The new rector should with luck be able to rise above this institutional farce. His broader task will still be daunting. A stroll in the conservatory grounds brings a mixture of impressions: a familiar cacophony from the practice rooms facing on to a Moscow backstreet, a cafeteria that no longer smells of stale cabbage, and a general state of disrepair that increases the farther you get from the offices of the main administration. Happily, a much needed renovation is at last under way.

It would be hard to say that, physically speaking, things are much worse now than, say, 50 or 100 years ago. Students and staff have, in any event, never paid great attention to their dilapidated and austere surroundings. The conservatory's history and prestige have always mattered to them more than wallpaper.

Founded in 1866, the conservatory's early success was assured by national pride and by money from the

imperial purse. It soon reached artistic parity with its sister-rival in St Petersburg. Once nationalised, after the revolution in 1917, the Moscow academy became pre-eminent.

Throughout, the consistently high calibre and dedication of the conservatory's teachers have contributed most to its extraordinary achievements. Neuhaus was only the best known of a brilliant group of teachers. The school continues to inculcate professional standards from a terrifyingly young age. Would-be students must undergo an assessment before they are even allowed to sit the gruelling entrance exams. And what pupils! They include the cellists Mstislav Rostropovich and Natalia Gutman, the pianists Tatiana Nikolayeva, Vladimir Ashkenazy and Mikhail Pletnev, the conductor Gennady Rozhdestvensky, and all four original members of the Borodin quartet.

Musical genealogies are recited at the conservatory with glee. Mr Ashkenazy, for example, studied under Lev Oborin, who taught at the school for over 40 years, having won the Chopin piano competition in Warsaw in 1927. Oborin in turn had studied under the legendary Konstantin Igumnov, a gold-medal winner in 1894. And so on, and so on. Or not quite. After Mr Ashkenazy won the Tchaikovsky competition at the conservatory, he did not stay to teach but chose to live in the West. And thereon hangs a vital point.

In the closed world of communism, Mr Ashkenazy was a rarity, even during the thaw of the Khrushchev period. Then, as now, lure of teaching or performing in the West was ever-present. The difference is that there is no longer anything to stop conservatory musicians from leaving. The freedom of musicians to work where they want, forbidden under the Soviet system, has come with a heavy price: making it worth teacher's while to stay.

Half full or half empty?

Natalya Shakhovskaya, a cello professor and department head who studied under Mr Rostropovich, sees the school and its troubles as a microcosm. Abrupt cuts in state support and corruption in management are familiar enough from other Russian cultural institutions. On the creative level, Ms Shakhovskaya insists that standards at the conservatory remain high, and she is confident that the difficulties at the top will be resolved.

Her optimism is not universally shared, especially among her younger colleagues. The prospect of teaching abroad both tempts and alarms them. Timirzhan Yerzhanov is an example. Demoralised after four years as a poorly paid assistant to the professor of piano, he is leaving to make his career in the United States. Other pianists—Dmitry Alexeev, Andrey Gavrilov and Mikhail Pletnev—have preferred international performing careers. On winning the Tchaikovsky competition in 1990, Boris Berezovsky left Russia after only three years of study at the conservatory.

With these leavers goes a probably irreplaceable concentration of musical knowledge. Previously you could talk about four distinct piano styles at the school—for the *cognoscenti* these were associated with Goldenweiser, Neuhaus, Flier and Oborin, though all of them would probably sound indistinguishably high-powered and romantic to non-Russian ears. They made prize pupils their assistants, who became professors and who continued to teach their distinctive styles. Now such a luxury of discrimination looks impossible to maintain. Younger teachers have lowered their sights to simply keeping alive a recognisably Russian tradition of pianism.

Standards, many complain, have also declined in the once formidable violin school, where David Oistrakh, Abram Yampolsky and Leonid Kogan used to teach. String teachers at the conservatory keep their own melancholy catalogue of colleagues who have left to teach violin in Europe and the United States.

Yet, for all the uncertainty, the conservatory's musical life is in some ways as vibrant as ever. It is a performing centre as well as a school. Its largest hall, Russia's most prestigious venue, is full for almost every concert. Ticket prices have soared, which is bad for Moscow's old musical intelligentsia. But so-called new Russians, who cannot tell Flier from Oborin but can afford the tickets, are taking their place. You can argue the toss as to whether this is a tradition dying or a tradition changing. Hard times for classical music are hardly unique to Russia. If the conservatory can find new sources of money, who knows, in time it may recover its old prowess.

Even now competition at the school for places remains stiff. In the piano faculty, there are five candidates for every place. New departments have opened for period performance and Russian sacred

music. For all its travails, the optimists will tell you that the Moscow Conservatory remains a bastion of Russian musical life. They make a brave case. Let us hope they are right.

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About sponsorship

Modern music in Moscow

Change from within

Jan 24th 2002 | MOSCOW
From The Economist print edition

The conservatory's modern music director sees opportunities, not difficulties

DESPITE next to no money, the Moscow conservatory's contemporary-music centre still manages to organise on average two concerts a month for its resident Studio for New Music ensemble, in addition to regular high-profile international festivals.

Surrounded by clutter in the office from which the centre has been run since 1994, its genial director, Vladimir Tarnopolsky, says he views the conservatory's recent upheavals as a welcome and necessary blood transfusion. The only avant-garde composer in a department still notorious for its conservatism (the famous troika of Denisov, Schnittke and Gubaidulina were *personae non gratae* during the Soviet period), Mr Tarnopolsky has been professor of composition since 1992. Like most of his colleagues, he lacks any trace of self-importance. He is visibly weary from the constant struggle of managing the ensemble's activities on a skeleton staff and a shoestring budget, while also keeping up with teaching duties and freelance commissions from abroad (a must on a salary of little more than $100 a month). Nevertheless, he relishes the challenge of building what he calls a Trojan horse of opposition from within, and remains resolutely cheerful.

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Sundance film festival

Digital revolution

Jan 24th 2002 | PARK CITY, UTAH
From The Economist print edition

New talent, new techniques

Reuters

I must leave Mr Wrong

TWO of the top prizes at this year's Sundance festival went to films shot on digital video. The winner of the Grand Jury prize, “Personal Velocity”, is a triptych concerning three women, each of whom must make an important decision about the man she is with. The film was adapted by writer-director Rebecca Miller (daughter of the noted American playwright) from a collection of her own short stories. Ms Miller, together with her director of photography, Ellen Kuras, has found a new way to tell a story on screen. Freeze-frame, slow motion, colour filters and smoke give the film a distinctly undigital tone, viscous and personal, that focuses attention on the excellent performances of Kyra Sedgwick, Parker Posey and Fairuza Balk. Ms Sedgwick's character decides to flee an abusive husband; Ms Posey's, to dump a cosy one; Ms Balk's, to keep a good one's child. “Personal Velocity” comes out of InDigEnt, an offshoot of the Independent Film Channel. Another InDigEnt offering, “Tadpole”, starring Sigourney Weaver, took the award for dramatic directing.

In the short film category, David Russo's “Populi” is the best and most creative cinema this reviewer has seen in years. Mr Russo uses articulated lasers, a technique of his own invention, to tell the story of man: a humanoid bust spins through natural and urban landscapes to Holst's “Mars: Bringer of War”, in a style reminiscent of both “Fantasia” and “Koyaanisqatsi”. “Populi” was the brightest of a selection of short films that outshone many of the features on offer. This, however, did not stop Hollywood from going on a spending spree. By the final weekend, buyers had spent a reported $17m on new films. “Personal Velocity” went for $1m. “Tadpole”, made for $150,000, if you can believe it, sold for nearly $5m.

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New communications

Learning the rules

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HOW lucky we are to have lived through a period of technological innovation. The sheer speed with which the Internet, once commercialised, became part of everyday life has provided a rare chance to see how innovation can transform social, corporate and political life. Perhaps not since the arrival of television have people been so conscious of the impact of change.

But how novel is the novelty? In a beautifully written book, subtitled "Cycles of Discovery, Chaos, and Wealth from the Compass to the Internet", Debora Spar, a professor at Harvard Business School, puts cyberspace in its place. She writes not only with historical depth but with acute observation. Earlier innovations in transport and communications shared many of the Internet's impacts, she insists. In particular, they demonstrate that new technologies do not remain indefinitely unregulated. They begin with swashbuckling independence: new players spring up, operating in a sort of new frontier, unconstrained by governments. But, once a technology acquires commercial importance, rules and standards emerge. Why? Because, argues Ms Spar, the industry's most successful companies want them.

Ruling the Waves
By Debora L. Spar

Harcourt; 352 pages; $27. Published as "Pirates, Prophets and Pioneers" by Random House UK (September 2001); £15.99

Buy it at
Amazon.com
Amazon.co.uk

Inventing the Electronic Century
By Alfred D. Chandler Jr

Free Press; 321 pages; $35.
Simon & Schuster; £25

Buy it at
Amazon.com
Amazon.co.uk

Commerce and politics need each other, she explains. As an industry expands—whether international shipping or the telegraph, radio or satellite television—the pioneers begin to want to consolidate their gains. To do so, they need enforceable property rights. So, in the mid-1920s, America's radio stations fought each other for frequencies until the resulting cacophony annoyed listeners and sales of radio sets began to slide. At that point, the larger radio stations begged Congress to take responsibility for allocating frequencies.

Because communications industries need intellectual property rights and common standards, they are particularly subject to the observation made long ago by Douglass North, an economic historian who pointed out that markets need the state in order to flourish. Will the Internet be different? Many of its pioneers saw it as an unregulated frontierland, where the writ of the state cannot run. However, Ms Spar insists, "there will be rules in cyberspace, and government will help to craft and enforce them. Why? Because even along this wildest of frontiers, pioneers need property rights and standards. And the only entity that can sustain and enforce these rules is the state."

Though this is broadly convincing, Ms Spar sometimes misses opportunities to develop issues. In particular, she fails to draw conclusions from Europe's preference for government ownership and a state monopoly (in telephony, radio and television) and America's preference for regulation backed by antitrust rules. And inevitably, some of the industries she studies fit her argument better than others.

The same is true of Alfred Chandler's account of the development of the consumer electronics and computer industries. Mr Chandler, the doyen of business history, still writing furiously in his Cambridge eyrie in his late 80s, is interested in "paths of learning": broadly, the way an organisation sets about developing and applying technologies. The concept, although central to the book, is sketchily and inadequately explained. However, Mr Chandler argues that the evolution of the consumer electronic and computer industries has been unique, because a single company—RCA in the first case, IBM in the second—defined the national industry's "paths of learning". The explanation for this unusual dominance lies, he believes, in the industries' underlying technologies. Earlier industries relied on a broad range of innovations; these two, on only four: the vacuum tube, the transistor, the integrated circuit and the microprocessor.

But paths of learning only lead so far: RCA's led into a thicket, from which Japan emerged as the world's leader in consumer electronics. And IBM has survived largely by reinventing itself. Companies need to be

lucky as well as learned to stay alive through a technological revolution.

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American juries

Getting it right

Jan 24th 2002
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IT WAS progress when medieval England replaced irrational forms of trial such as the ordeal—in which a defendant's veracity was tested by torture—with trial by jury. The jury soon became standard in criminal and civil cases at common law, and its use spread with the British empire, nowhere more so than in the American colonies. Someone has calculated that nowadays over 90% of jury trials take place in the United States.

These two very different books scrutinise the modern American jury. Graham Burnett, a young historian of science, served as the foreman of a jury examining an admitted killing in Manhattan's gay demi-monde. The accused pleaded self-defence. Although one of the other 11 members of the jury was, improbably, also a historian of science, two and possibly a third showed the mental acuity of fireplugs. The lawyers were mediocre, the police sloppy, the judge an unhelpful petty tyrant. All in all, it was not untypical.

A Trial by Jury
By D. Graham Burnett

Knopf (September 2001); 192 pages; $21. Bloomsbury; £14.99

Buy it at
Amazon.com
Amazon.co.uk

Stack and Sway: The New Science of Jury Consulting
By Neil J. Kressel and Dorit F. Kressel

Westview; 308 pages; $27.50

Buy it at
Amazon.com

Jury selection took four days, the hearing of evidence ten days. Then came three days and four nights of isolation attended by armed guards. The jurors, “ran the gamut of group dynamics: a clutch of strangers yelled, cursed, rolled on the floor, vomited, whispered, embraced, sobbed and invoked both God and necromancy.” Views shifted, including Mr Burnett's. Somehow a verdict was reached, and it sounds the right one. “A Trial by Jury” is a remarkable achievement. No jury is quite alike, and this was a sample of one. But rarely have we had so lucid an account by such an observant participant of what goes on behind the cloak of jury secrecy.

What goes on before jurors even take their oaths can decide who wins. So many lawyers and clients believe, encouraged by jury consultants. Their use is now common in America when the financial stakes are high or when the criminal defendants are rich. But how effective are they?

Neil and Dorit Kressel, a social psychologist and a lawyer, have looked into the question of jury consulting and reached a reassuring conclusion. Trials in which jury selection makes a decisive difference are rare, they believe: most cases are decided on the evidence.

Jury consultants, for all that, are not totally useless. By staging mock trials or convening focus groups they can make a good guess about how trials will come out, which may encourage settlement. They can show lawyers and witnesses how to be more sympathetic and effective. They can test different trial strategies, including different versions of the facts. That sounds disquieting. But trial lawyers have always done something like this when thinking about the presentation of evidence, only less systematically.

How well, with or without consultants, does the jury system work? Mr Burnett was frustrated not to be able to ask questions or even to take notes. Judges' instructions to juries are often aimed less at clarifying their understanding of the facts than at placating appeals courts. How well most jurors understand technical or financial complexities is open to doubt.

Nevertheless, an overwhelming majority of Americans consider juries the fairest way of determining guilt. All but 3% of federal judges said in a survey that they agreed with jury verdicts most or all of the time. Tellingly, they said that if they were on trial, they would rather face a jury than a judge. The lesson of these two fine books is that, like democracy, in its own messy way, the jury somehow works. Mr Burnett's is readable, into the bargain.

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About sponsorship

Recent events on film

Up close and historical

Jan 24th 2002
From The Economist print edition

Not all history happens on the street—even in films

ONE thing about historical events is that nobody ever really witnesses them in full. Even participants see only bits and pieces. This is always a problem for film makers who tackle historical themes, especially recent ones about which viewers can be expected to know a thing or two.

Film makers try to solve this problem in different ways. One way is to plunge viewers, noisily and chaotically, into the action. This is what Paul Greengrass does in “Bloody Sunday”, a docudrama about the killing of 13 Catholic protesters by British soldiers in Londonderry in 1972. It is what Ridley Scott does in “Black Hawk Down”, a battle film about a bungled American search raid in Mogadishu in 1993, when 19 American soldiers died. In both films, new equipment—much of which didn't exist at the time of the events depicted—allows film makers to give us a feeling of closeness and immediacy that is overwhelming.

Each film is authentic in its way. Mr Greengrass is scrupulous not to show more than is known. He presents Bloody Sunday as an unplanned massacre that silenced moderates and sent Northern Ireland towards three needless decades of extremism. Mr Scott gives little background to America's intervention in Somalia; the Somalis shooting at Americans—and each other—are stage shadows; and the American victims are heroised. Yet the film never conceals that we are watching a military blunder.

A weakness with both films is that the view from the street is not the only view. History happens also in offices. Rows among politicians and generals led up to Derry and Mogadishu. A quieter, not always duller, way to dramatise history borrows from the documentary. An excellent recent example is “Thirteen Days” by Roger Donaldson (2000), on the Cuban missile crisis of 1962. Based on White House transcripts and memoirs, it provides real insight into high-level, life-and-death decision-making under stress. We know what happens, or doesn't happen, in the end. There is no blood. But it is a powerful and convincing account of conflict all the same.

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About sponsorship

The sense of touch

Losing our common sense

Jan 24th 2002
From The Economist print edition

Touch
By Tiffany Field

MIT Press; 194 pages; $22.95 and £15.95

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A BOOK like this, and the academic research it synthesises, could only arise from a world gone mad. In certain American school districts, teachers are being instructed not to touch students for fear of sexual-abuse lawsuits. They must not pick up a nursery child when it falls over in the playground. In 1996, a six-year-old boy was sent home when he kissed a schoolmate's cheek.

The madness started in the 1930s when academics began telling parents not to pick up their crying babies, not to hug or kiss them (or "once on the forehead when they say goodnight") and otherwise to shake their hand. In the late 1940s, Dr Benjamin Spock (oddly, not mentioned here) countered with his sensible, relaxed and hugely popular "Common Sense Book of Baby and Child Care". But the backlash against the permissive society, and anxiety over sexual abuse, dethroned Dr Spock. And, once lost, common sense can only be recovered, it seems, by way of science and peer-group review.

It turns out that hormones, body chemicals and even genes agree that hugging is good for you. Growth hormones decline in rats deprived of their mothers' habitual licking. Baby monkeys removed from parental grooming sessions produce fewer antibodies. Premature babies who receive regular massage put on 47% more weight than non-massaged ones. Cortisol levels (the stress hormone) in depressed adolescents go down after massage. EEG patterns measured after massage indicate heightened awareness. Anorexics, asthmatics, cancer patients, HIV-positive infants, psychiatric patients, the elderly, the young—all, we are told, benefit.

Ms Field is at her best when bringing together the results of specific studies. Her broad anthropological and social conclusions, however, can sometimes be tendentious. Touch, she insists, is not only the key to health and happiness but to social cohesion—even to war and peace. The tactile Japanese are social beings as against the non-tactile, non-social Americans. And consider the Arapesh people of New Guinea, who carry their babies in net bags, always in contact with the mother. They are peaceful. Contrast the Mundugamor, whose babies are carried in baskets, out of contact. They are warlike. But what about the Japanese?

Ms Field's insouciance can, unwittingly, strike a chill. Corporations have found that office massages, instead of coffee breaks, make their workers happy and speed up their work rates. Aldous Huxley would have relished this book: "Oh brave new world that has such Touch Research Institutes in it!"

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About sponsorship

Poetry in translation

Finding the words

Jan 24th 2002
From The Economist print edition

Translating poetry is impossible but worthwhile

THE title, it must be admitted, is unpromising, but “A Treatise on Poetry” is gripping, profound and beautiful. It is a book-length poem by the Nobel-prize-winning author Czeslaw Milosz, who recently turned 90. It was written, though, in the 1950s, not long after Mr Milosz, then a Polish diplomat, opted for exile in America. Mr Milosz, who participates in his poetry's translation, had long thought it untranslatable. One can see why, for it is essentially a versified history of modern Polish poetry, which is unlikely to mean much to foreign readers. Yet the history that Mr Milosz has witnessed epitomises the tragic story of Europe for nearly a century: from the first world war to the fall of the great monarchies, from Auschwitz and the Warsaw ghetto to the imposition of Soviet control, from the struggles of Solidarity to the globalised market-place. The history of Polish verse, as Mr Milosz tells it here, is the history of much else as well. The local is made convincingly universal.

But poetry, as Robert Frost once said, “is what gets lost in translation”. Nonetheless, poets like Mr Milosz persist in the impossible task, conscious that they can never do more than suggest a ghostly outline of the original. One could pick holes in Robert Hass's translation of “A Treatise on Poetry”—a regular metre, especially in the lyrical sections, might have worked better—but this reviewer came away with the feeling of having just read a great poem. Mr Milosz has helpfully supplied factual and reflective notes, which fill as many pages as the poem. Notes can be distracting, but these amplify, like a fragmentary essay.

Mr Milosz has, in fact, written such essays before. His “Notes on Exile” is one of the most impressive of the essays selected for another extraordinary book, “To Begin Where I Am”. These 400 or so pages document the development, over seven decades, of a great mind. Mr Milosz is as much a philosopher as a literary critic, though one with a practical turn of mind, a wry sense of humour and a taste for irreducible particulars. His interests are wide-ranging, and take in science, politics and theology. This is something readers of his verse have long been conscious of. They will be reminded of it again when they place these essays beside a new edition of the poems. “New and Collected Poems, 1931-2001” includes “A Treatise on Poetry”, as well as 150 poems written since the last “Collected” volume was published.

Mr Milosz once wrote that exile is the worst fate that may befall a poet, since poetry cannot live without its roots in native speech. Yet he has kept on writing with an optimistic edge to his realism, and has seen his poems achieve international fame. In 1945 he began a poem to an unnamed victim of the Warsaw Uprising with the words “You whom I could not save/Listen to me”, and concluded:

> They used to pour millet on graves or poppy seed
> To feed the dead who would come disguised as birds.
> I put this book here for you, who once lived
> So that you should visit us no more.

These lines are now as unforgettable as if they had first been written in our

A Treatise on Poetry
Translated by Robert Hass and Czeslaw Milosz

Ecco; 125 pages; $23

Buy it at
Amazon.com
Amazon.co.uk

To Begin Where I Am: Selected Essays
By Czeslaw Milosz
Edited by Bogdana Carpenter and Madeline G. Levine

Farrar, Straus and Giroux; 478 pages; $30

Buy it at
Amazon.com
Amazon.co.uk

New and Collected Poems, 1931-2001
By Czeslaw Milosz

Ecco; 800 pages; $45. Allen Lane, The Penguin Press; £30

Buy it at
Amazon.com
Amazon.co.uk

Collected Poems in English
By Joseph Brodsky

Farrar, Straus and Giroux; 554 pages; $30. Carcanet Press; £14.95

Buy it at
Amazon.com
Amazon.co.uk

Selected Poems and Prose of Paul Celan
Translated by John Felstiner

Norton; 426 pages; $17.95 (paperback) and £23 (hardback)

Buy it at
Amazon.com
Amazon.co.uk

language.

The same cannot be said for anything in Joseph Brodsky's “Collected Poems in English”. Brodsky, who died six years ago, had much in common with Mr Milosz. They were friends, both Slavic exiles, both Nobel prizewinners, both tirelessly prolific. The big contrast is that Brodsky is locked away in his native Russian. Much the best poems in this volume are those translated by important American poets—Richard Wilbur, Anthony Hecht and others. But, as Brodsky himself seems to have felt, they are so well done that they lack any trace of his Russian identity. As a result, he tried to mastermind his own translation, somewhat in the manner of Mr Milosz. The results are almost always simply leaden. Brodsky was fluent in English, but he had no feeling for the movement of the language and accepted translations that are frankly turgid. His own attempts at writing in English are embarrassingly clumsy. The greater pity is that in several of the poems—in the woefully translated long poem “Gorbunov and Gorchakov”, for example—one seems to glimpse the shadow of great poetry.

The problem with Brodsky is partly a formal one. Like most Russian poets, the effect of his work depends on rhyme and metre, which are hard to reproduce. But which poets happen to translate well is unpredictable. Paul Celan, a German-speaking Romanian Jew, was long thought untranslatable, his deeply hermetic poetry depending on nuance, ambiguity and verbal duplicity. But Celan, who died in 1970, wrote one of the most famous of post-war poems, “Deathfugue”, a haunting incantation about the Holocaust:

> black milk of daybreak we drink it at evening
> we drink it at midday and morning we drink it at night
> we drink and we drink
> we shovel a grave in the air where you won't lie too cramped

“Death”, he concludes, with German fugues in mind, “is a Master from Deutschland.” The quotation comes from a new translation by Celan's distinguished biographer, John Felstiner. It is at least the fourth that this reviewer has read and, though not the best of them, it comes across as powerfully as any. Mr Felstiner's ear is a shade less subtle than his rival Michael Hamburger's, but several of his readings are newly illuminating. “Selected Poems and Prose of Paul Celan” is the largest selection yet published and, along with the famous pieces, includes some essays, lectures and early poems. Despite his elusiveness, Celan seems to inspire English translators, so that he, like the much more accessible Czeslaw Milosz, must now be seen as a classic of world literature.

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About sponsorship

Camilo José Cela

Jan 24th 2002
From The Economist print edition

Camilo José Cela, Spain's foremost novelist, died on January 17th, aged 85

EPA

THE first school Camilo José Cela attended expelled him, at the age of six, for biting a teacher, a nun. His second school didn't much care for him either, and also gave him the push. He managed to reach university, but never took a degree. He said he never cared for textbooks; and, tedious though such works may be, they tend to be essential for the three disciplines Mr Cela had a go at, medicine, philosophy and law. Among the activities he enjoyed, he liked to tell his put-upon tutors, were "wandering" and "observing".

He said later that his mischievous childhood, in a prosperous family of eight siblings, was so happy that he found it hard to grow up. But in 1936, when Mr Cela was 20, civil war broke out in Spain. He joined the forces of Francisco Franco, who, supported by Germany and Italy, rehearsing their armies for the second world war, established a dictatorship which he led until his death in 1975.

Mr Cela's early years, varied in experience but perhaps no more remarkable than those spent by many young Spaniards, became increasingly interesting to a wide public as his fame grew as a writer. When he won the Nobel prize for literature in 1989, the Swedish judges said that his novel "The Family of Pascual Duarte" was the most popular work of fiction in Spanish since Cervantes's "Don Quixote", published nearly 400 years earlier.

As well as having a big following in Spain, Mr Cela has had huge sales in Latin America, and has been widely translated. He was extremely prolific. Apart from publishing 14 novels, he produced poetry, plays, film scripts and newspaper articles, all of them handwritten. He had a pencil in hand, making notes, on the day before he died.

Living in a dictatorship

Throughout the years of Franco's rule, Mr Cela maintained an ambiguous relationship with the regime. After fighting for Franco he worked briefly as a censor. He said later that he needed the money and anyway only leafed perfunctorily through technical magazines that did not really need censoring. As a public figure he portrayed himself as a provocateur but never provoked so much that he jeopardised his personal freedom.

Mr Cela's novels contain implicit criticism of Franco's Spain, and his love of the scatological and erotic was an affront to the moralistic conventions of the day. Some of his books were first published in the freer countries of Latin America. At one stage he moved from Madrid to Majorca, away from the immediate gaze of Franco's henchmen, and founded a magazine that printed the work of exiled writers. But he was never an open adversary.

Franco, like many dictators, valued the trappings of respectability provided by the arts. Two of Spain's most gifted artists, Picasso and the cellist Pablo Casals, chose exile rather than live under the dictatorship. In contrast, Franco was able to point to Mr Cela as an eminent writer who had stayed in Spain and wrote with considerable freedom. He overlooked Mr Cela's defence of colleagues who wrote in Catalan, Basque and Galician, languages that were formally banned. In 1957 his election to the Royal Academy of Language consolidated Mr Cela as a member of Spain's cultural establishment. After Franco's death, younger, leftist writers were gaining attention. Still, the Nobel was good to have, and in 1995 he was awarded the Cervantes prize, which he had coveted and grumbled that it had come along rather late

in the day.

Money and fame and the freedom of the post-Franco era brought changes in his life. He left his wife and, after an acrimonious divorce, in 1991 married Martina Castaño, a journalist, with him in our picture. Into his 80s Mr Cela led a glitzy lifestyle with his young wife, much featured in Spain's flashy magazines. It became common for other writers to contrast the idealistic Camilo José Cela of early years with what they saw as a richer and arrogant version, one who had punched an intrusive gossip columnist and a photographer. Perhaps they were jealous.

Critics took a closer look at their most-prized writer, not always to his benefit. Mr Cela's early writing is valued more than his later work. The Nobel judges picked out “Pascual Duarte”, published in 1942. This and “La Colmena” (“The Hive”), from 1951, reflect the harshness of life in Spain in the 1930s. At the time of his Nobel Mr Cela's work was little known in English-speaking countries, and it is too early to say whether it will have the universal appeal of “Don Quixote”. Translations are necessarily rewrites of the original, and Mr Cela's exquisite Castilian Spanish may not travel easily.

He liked to experiment: “What's the point of repeating what has already been done?” His later fiction makes scant use of punctuation and appears to lie between prose and poetry. In a 1981 film of “La Colmena”, which interweaves the stories of customers at a Madrid café, Mr Cela appeared in a cameo role as someone fascinated by words, which he was in real life. He published what he called a “secret dictionary” compiled of crude and blasphemous words used in everyday speech. He once said that getting the obscene word *coño* into an important Spanish dictionary was one of his greatest triumphs. It was hard to grow up.

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Overview

Jan 24th 2002
From The Economist print edition

The mood of **American** consumers continues to brighten. The University of Michigan's consumer-sentiment index rose from 88.8 in December to 94.2 in January, its highest for a year. The rise, which was faster than analysts had expected, is the survey's fourth successive monthly increase since the terrorist attacks last September.

More good news came from the Conference Board's index of leading economic indicators, which rose by 1.2% in December, its largest gain in almost six years, bolstering hopes of a speedy recovery in the American economy.

America's trade deficit narrowed to $434.0 billion in the year to November, thanks mostly to oil: prices were lower and the manufacturing slowdown reduced oil demand.

Falling oil prices had similar effects on **Canada's** trade surplus, which narrowed slightly in the year to November to $42.5 billion, and on inflation, which fell to a near three-year low of 0.7% in the year to December.

In the year to November, the **euro area's** trade surplus widened to $32.6 billion, up from a deficit of $8.5 billion in the previous 12 months. Industrial production fell by 4.3%. The drop in factory output was the biggest since July 1993. **Italy's** industrial production was hit harder than that of most other countries, falling by 2.6% during the month in its biggest decline in nine years. Inflation in the euro area was 2.1% in the 12 months to December; **Germany's** wholesale prices fell by 1.5% in the same period.

The global economic slowdown is having little effect on unemployment in **Sweden**, which fell to 3.6% in December, from 3.7% in November. **Switzerland's** producer prices fell by 1.9% in the year to December.

British manufacturers' pain increased. The Confederation of British Industry's Industrial Trends Survey revealed that the balance of firms reporting rising production over those reporting a decline worsened to –13 in January from –11 in December. Britain's trade deficit widened to $41.1 billion in the year to November. In the year to December, broad-money growth slowed to 6.7%.

The **yen** fell by 1.5% to a three-year low against the dollar, as comments by America's visiting treasury secretary were construed as tacit approval of a weaker Japanese currency.

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Output, demand and jobs

Jan 24th 2002
From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2001	2002	latest	latest	latest	year ago
Australia	+ 4.6	+ 2.5 Q3	+ 2.1	+ 3.2	+ 0.4 Q3	+ 5.8 Q3	6.7 Dec	6.3
Austria	– 0.3	+ 0.9 Q3	+ 1.1	+ 1.0	– 1.3 Oct	– 4.8 Sep	4.0 Nov	3.6
Belgium	+ 0.1	+ 0.6 Q3	+ 1.2	+ 1.0	– 9.3 Nov*	– 2.5 Oct	10.8 Dec*	10.6
Britain	+ 1.7	+ 2.2 Q3	+ 2.2	+ 1.8	– 4.8 Nov	+ 5.7 Dec	5.1 Nov†	5.3
Canada	– 0.8	+ 0.8 Q3	+ 1.4	+ 1.2	– 6.0 Oct**	+ 2.1 Oct	8.0 Dec	6.8
Denmark	+ 3.5	+ 1.4 Q3	+ 1.1	+ 1.3	+ 0.8 Nov	+ 0.9 Oct	5.0 Nov	5.5
France	+ 1.9	+ 2.0 Q3	+ 2.0	+ 1.3	– 0.9 Nov	– 0.8 Nov	9.0 Nov	9.1
Germany	– 0.6	+ 0.3 Q3	+ 0.7	+ 0.6	– 4.8 Nov	– 0.4 Nov	9.5 Dec††	9.3
Italy	+ 0.6	+ 1.9 Q3	+ 1.8	+ 1.0	– 5.8 Nov	– 0.3 Oct	9.3 Oct	10.0
Japan	– 2.2	– 0.5 Q3	– 0.4	– 1.2	-13.0 Nov	– 1.9 Nov	5.5 Nov	4.8
Netherlands	– 1.4	+ 0.4 Q3	+ 0.9	+ 1.0	– 5.3 Nov	+ 3.2 Oct	1.9 Dec§	2.6
Spain	+ 1.1	+ 2.8 Q3	+ 2.6	+ 1.8	– 4.7 Nov	na	13.0 Nov	13.6
Sweden	+ 0.2	+ 0.4 Q3	+ 1.3	+ 1.4	– 5.1 Nov	+ 2.6 Nov	3.6 Dec*	3.7
Switzerland	+ 0.1	+ 0.8 Q3	+ 1.5	+ 0.9	+ 1.9 Q3*	+ 4.3 Nov	2.4 Dec*	1.9
United States	– 1.1	+ 0.6 Q3	+ 1.1	+ 0.7	– 5.8 Dec	+ 5.4 Nov	5.8 Dec	4.0
Euro area	+ 0.4	+ 1.4 Q3	+ 1.5	+ 1.0	– 4.3 Nov	– 0.5 Oct	8.5 Nov	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 5.0	nil Q3	na	na	– 4.8 Nov	+ 5.0 Oct	8.1 Dec*	8.3
Greece	na	+ 4.4 Q3	na	na	+ 2.0 Oct*	+ 4.1 Oct	na	na
Iceland	na	+ 3.62000	na	na	+ 2.5 2000	na	1.6 Nov	1.2
Ireland	na	+ 9.2 Q2	na	na	– 8.0 Nov	+ 3.2 Oct	4.1 Dec	3.6
Luxembourg	na	+ 8.52000	na	na	+ 7.8 Sep	+10.0 Oct	2.7 Nov	2.6
New Zealand	+ 2.8	+ 2.1 Q3	na	na	+ 2.6 Q3*	+ 6.3 Q3	5.2 Q3	5.8
Norway	+ 3.8	+ 1.9 Q3	na	na	– 2.5 Nov	+ 2.2 Dec	3.6 Q3	3.5
Portugal	+ 1.6	+ 2.5 Q2	na	na	+ 2.9 Nov	+ 4.9 Nov	4.0 Q3	4.0

*Not seasonally adjusted. †Sep-Nov; claimant count rate 3.2% in Dec. §Oct-Dec. **New series. ††EU harmonised rate 8.0% in Dec.

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Prices and wages

Jan 24th 2002
From The Economist print edition

% change at annual rate

	Consumer prices* latest		Consumer prices* year ago	The Economist poll consumer prices forecast 2001	The Economist poll consumer prices forecast 2002	Producer prices* latest		Producer prices* year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 3.1	Q4	+ 5.8	+ 4.2	+ 2.4	– 0.7	Q4	+ 8.4	+ 4.0	Q3	+ 6.5
Austria	+ 1.9	Dec	+ 2.6	+ 2.5	+ 1.4	– 1.1	Dec	+ 4.4	+ 2.7	Nov	+ 2.2
Belgium	+ 2.2	Dec	+ 2.5	+ 2.5	+ 1.5	– 3.6	Nov	+10.2	+ 3.1	Q4	+ 1.6
Britain	+ 0.7	Dec	+ 2.9	+ 1.9	+ 1.9	– 1.2	Dec	+ 2.3	+ 4.2	Nov	+ 4.2
Canada	+ 0.7	Dec	+ 3.2	+ 2.6	+ 1.5	– 1.9	Nov	+ 5.3	+ 2.4	Oct	+ 2.4
Denmark	+ 2.2	Dec	+ 2.4	+ 2.3	+ 1.9	+ 0.4	Dec	+ 3.9	+ 4.3	Q3	+ 3.8
France	+ 1.4	Dec	+ 1.6	+ 1.7	+ 1.1	– 2.3	Nov	+ 6.3	+ 4.1	Q3	+ 5.3
Germany	+ 1.7	Dec	+ 2.2	+ 2.4	+ 1.1	– 1.5	Dec	+ 5.1	+ 1.9	Nov	+ 1.8
Italy	+ 2.4	Dec	+ 2.7	+ 2.7	+ 1.6	– 1.3	Nov	+ 6.7	+ 2.8	Nov*	+ 1.8
Japan	– 1.0	Nov	– 0.8	– 0.7	– 1.0	– 0.8	Dec	+ 1.1	– 0.8	Nov*	nil
Netherlands	+ 4.4	Dec	+ 2.9	+ 4.8	+ 2.2	– 2.3	Nov	+ 9.0	+ 4.6	Nov	+ 3.3
Spain	+ 2.7	Dec	+ 4.0	+ 3.6	+ 2.2	– 0.8	Nov	+ 5.7	+ 3.6	Q3†	na
Sweden	+ 2.9	Dec	+ 1.4	+ 2.5	+ 1.9	– 0.9	Nov	+ 4.8	+ 2.5	Oct*	+ 3.0
Switzerland	+ 0.3	Dec	+ 1.5	+ 1.0	+ 0.6	– 1.9	Dec	+ 2.2	+ 1.3	2000	+ 0.3
United States	+ 1.6	Dec	+ 3.4	+ 2.9	+ 1.5	– 1.8	Dec	+ 3.6	+ 4.1	Dec	+ 4.4
Euro area	+ 2.1	Dec	+ 2.6	+ 2.6	+ 1.4	– 1.3	Nov	+ 6.4	+ 3.0	Q2	+ 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.6	Dec	+ 3.5	na	na	– 2.7	Dec	+ 5.9	+ 4.5	Q3*	+ 4.9
Greece	+ 3.0	Dec	+ 3.9	na	na	+ 0.2	Nov	+ 9.0	na		na
Iceland	+ 9.4	Jan	+ 3.5	na	na	+11.4	Jan	+ 4.4	+ 9.6	Dec	+ 7.6
Ireland	+ 4.2	Dec	+ 5.9	na	na	+ 0.5	Nov	+ 5.9	+ 8.7	Q3*	+ 7.4
Luxembourg	+ 1.7	Dec	+ 3.5	na	na	– 1.1	Nov	+ 5.0	+ 3.4	Aug*	+ 7.0
New Zealand	+ 1.7	Q4	+ 4.0	na	na	+ 6.2	Q3	+ 8.4	+ 2.0	Q3	+ 1.5
Norway	+ 2.1	Dec	+ 3.0	na	na	–14.1	Dec	+ 9.0	+ 4.6	Q3*	+ 4.2
Portugal	+ 3.7	Dec	+ 3.9	na	na	– 7.9	Nov	+16.8	+ 2.4	Apr*	na

*Not seasonally adjusted. †New series.

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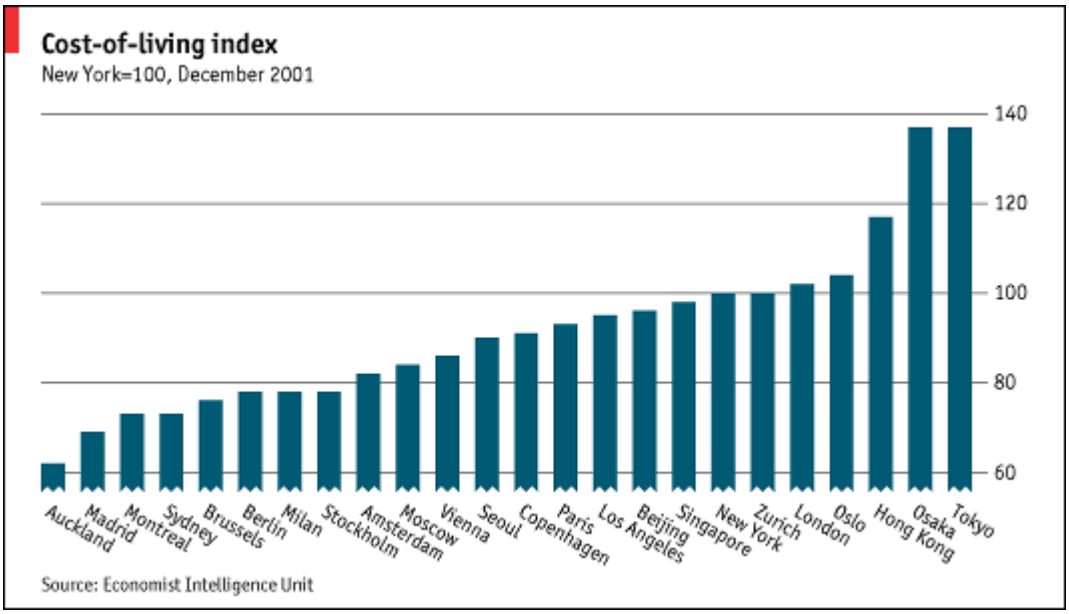
Cost-of-living index

Jan 24th 2002
From The Economist print edition

Tokyo and Osaka are the world's most expensive cities, according to a survey by the Economist Intelligence Unit, a sister company of *The Economist*. Living in Japan costs one-third more than it does in New York. London, slightly dearer than the Big Apple, is the most expensive city in the European Union, justifying its pricey reputation. But non-EU Oslo is more expensive, and Zurich comes close.



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Money and interest rates

Jan 24th 2002
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jan 23rd 2002) 3-mth money market		2-year gov't bonds	10-year gov't bonds		corporate bonds
	narrow	broad		latest	year ago		latest	year ago	
Australia	+21.1	+14.1	Nov	4.25	5.95	4.61	5.88	5.41	6.76
Britain	+ 8.3	+ 6.7	Dec	3.94	5.75	4.50	4.82	4.86	5.94
Canada	+15.4	+ 4.9	Nov	1.93	5.26	3.13	5.41	5.52	6.83
Denmark	+ 7.8	+ 6.4	Nov	3.55	5.38	4.22	4.97	5.16	7.07
Japan	+13.7	+ 3.4	Dec	0.03	0.42	0.07	1.43	1.46	1.52
Sweden	+ 7.1	+ 6.2	Nov	3.77	4.07	4.59	5.18	4.95	5.29
Switzerland	+ 6.3	+ 4.7	Dec	1.72	3.44	2.45	3.39	3.48	4.48
United States	+ 8.2	+13.5	Dec	1.70	5.35	3.01	5.02	5.31	6.73
Euro area†	+ 6.1	+ 8.0	Nov	3.36	4.68	3.79	4.75	4.82	5.38

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.46%, Japan No.235 1.44%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jan 24th 2002
From The Economist print edition

1995=100

	Jan 15th	Jan 22nd*	% change on one month	% change on one year
Dollar index				
All items	67.8	67.2	+ 2.8	- 8.6
Food	69.6	68.6	+ 2.0	- 5.2
Industrials				
All	65.3	65.3	+ 4.0	-13.0
Nfa†	61.7	63.5	+ 6.5	- 4.6
Metals	68.3	66.8	+ 2.1	-18.8
Sterling index				
All items	74.0	74.2	+ 3.6	- 5.8
Euro index				
All items	100.0	100.2	+ 3.3	- 2.7
Yen index				
All items	94.7	96.0	+ 6.5	+ 4.7
Gold				
$ per oz	284.90	282.35	+ 1.7	+ 6.1
West Texas Intermediate				
$ per barrel	20.01	19.43	+ 4.5	-34.2

*Provisional. †Non-food agriculturals.

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Stockmarkets

Jan 24th 2002
From The Economist print edition

Market indices

	Jan 23rd	2001-02 high	2001-02 low	% change on one week	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,363.7	3,425.2	2,867.4	- 0.1	- 1.8	+ 6.6	- 0.3
Austria (ATX)	1,150.9	1,245.8	1,014.3	+ 2.4	-33.7	+ 7.2	+ 0.9
Belgium (Bel 20)	2,771.0	3,030.4	2,322.6	+ 4.7	-24.7	- 8.4	-13.7
Britain (FTSE 100)	5,180.6	6,334.5	4,433.7	+ 1.0	-25.2	-16.7	-20.5
Canada (Toronto Composite)	7,598.5	9,348.4	6,513.1	+ 0.2	-33.3	-14.9	-20.5
Denmark (KBX)	220.4	294.3	197.8	+ 0.3	-27.0	-16.7	-21.2
France (SBF 250)	2,900.5	3,820.2	2,335.3	+ 0.3	-33.9	-23.1	-27.6
(CAC 40)	4,450.8	5,998.5	3,652.9	+ 0.6	-35.7	-24.9	-29.3
Germany (Xetra DAX)	5,163.0	6,795.1	3,787.2	+ 3.6	-36.0	-19.7	-24.4
Italy (BCI)	1,408.5	1,948.4	1,082.9	+ 0.8	-35.5	-26.5	-30.8
Japan (Nikkei 225)	10,040.9	14,529.4	9,504.4	- 1.3	-74.2	-27.2	-38.0
(Topix)	975.2	1,441.0	863.4	- 1.3	-66.2	-24.0	-35.3
Netherlands (AEX)	492.6	642.3	396.2	+ 0.7	-29.8	-22.7	-27.3
Spain (Madrid SE)	802.2	963.9	648.6	+ 3.2	-30.0	- 8.9	-14.2
Sweden (Affarsvarlden Gen)	219.8	293.1	177.5	+ 1.0	-45.1	-20.9	-28.8
Switzerland (Swiss Market)	6,310.0	8,135.4	5,110.2	+ 1.1	-25.0	-22.4	-24.5
United States (DJIA)	9,731.0	11,337.9	8,235.8	+ 0.2	-17.0	- 9.8	- 9.8
(S&P 500)	1,128.2	1,373.7	965.8	+ 0.1	-26.1	-14.5	-14.5
(Nasdaq Comp)	1,922.4	2,859.2	1,423.2	- 1.1	-61.9	-22.2	-22.2
Europe (FTSE Eurotop 300)*	1,230.3	1,545.5	998.9	+ 1.2	-27.8	-19.8	-24.5
Euro area (FTSE Ebloc 100)*	1,074.5	1,404.1	843.6	+ 1.7	-30.7	-22.8	-27.3
World (MSCI)†	977.3	1,249.2	856.6	nil	-32.5	na	-20.0
World bond market (Salomon)‡	436.8	461.7	420.6	- 0.9	- 5.0	na	- 1.6

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Schroder Salomon Smith Barney World Government Bond Index, total return, in dollar terms.

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Trade, exchange rates and budgets

Jan 24th 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2001	2002	Exchange rate trade-weighted† Jan 23rd	year ago	Currency units per $ Jan 23rd	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2001‡
Australia	+ 2.1	Nov	− 8.5	Q3	− 2.3	− 2.8	74.9	74.2	1.92	1.84	2.74	1.70	1.43	0.1
Austria	− 5.0	Oct	− 4.3	Nov	− 2.5	− 2.2	100.3	100.5	15.6	14.9	22.2	13.8	11.6	nil
Belgium	+ 12.2	Nov	+ 12.4	Sep	+ 3.9	+ 4.2	99.1	99.3	45.6	43.7	65.1	40.3	34.0	nil
Britain	− 41.1	Nov	− 17.7	Q3	− 1.7	− 2.2	106.4	104.4	0.70	0.69	–	0.62	0.52	1.1
Canada	+ 42.5	Nov	+ 23.9	Q3	+ 2.7	+ 1.7	75.3	79.0	1.61	1.51	2.29	1.42	1.20	2.8
Denmark	+ 7.5	Nov	+ 4.8	Nov	+ 2.5	+ 2.1	102.5	101.9	8.41	8.09	12.0	7.43	6.27	2.0
France	+ 2.7	Nov	+ 24.1	Nov	+ 1.6	+ 1.5	101.7	102.1	7.42	7.11	10.6	6.56	5.53	-1.5
Germany	+ 70.7	Nov	− 4.5	Nov	− 0.6	− 0.3	98.8	99.0	2.21	2.12	3.15	1.96	1.65	-2.5
Italy	+ 4.9	Oct	− 1.7	Oct	− 0.2	+ 0.2	72.6	72.8	2,190	2,098	3,123	1,936	1,634	-1.4
Japan	+ 72.9	Nov	+ 89.9	Nov	+ 2.0	+ 2.0	126.3	140.7	134	118	191	119	–	-6.4
Netherlands	+ 19.3	Oct	+ 11.1	Q3	+ 3.7	+ 3.9	98.0	98.3	2.49	2.39	3.55	2.20	1.86	1.1
Spain	− 38.4	Oct	− 14.1	Oct	− 2.5	− 2.3	74.3	74.5	188	180	268	166	140	nil
Sweden	+ 12.5	Nov	+ 6.3	Nov	+ 2.4	+ 2.3	75.5	79.1	10.48	9.65	14.9	9.27	7.82	3.8
Switzerland	+ 0.7	Nov	+ 25.4	Q3	+10.7	+11.1	112.5	108.2	1.67	1.66	2.37	1.47	1.24	na
United States	−434.0	Nov	−430.7	Q3	− 4.1	− 4.0	123.8	115.3	–	–	1.43	0.88	0.75	0.6
Euro area	+ 32.6	Nov	− 31.2	Oct	+ 0.2	− 0.1	79.1	80.7	1.13	1.08	1.61	–	0.84	-1.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 11.1	Nov	+ 8.5	Nov	na	na	78.4	78.2	6.73	6.44	9.59	5.95	5.02	3.7
Greece	− 7.7	Oct	− 7.2	Sep	na	na	57.6	57.6	386	369	550	341	288	0.2
Iceland	− 0.2	Nov	− 0.7	Q3	na	na	na	na	102	86.4	146	90.5	76.4	-0.2
Ireland	+ 31.8	Oct	− 1.5	Q2	na	na	87.4	88.2	0.89	0.85	1.26	0.78	0.66	3.2
Luxembourg	− 2.8	Sep	+ 1.2	Q2	na	na	99.1	99.3	45.6	43.7	65.0	40.3	34.0	5.3
New Zealand	+ 0.4	Nov	− 0.2	Q3	na	na	84.1	81.2	2.33	2.28	3.33	2.06	1.74	1.3
Norway	+ 25.5	Dec	+ 26.0	Oct	na	na	97.1	93.1	8.95	8.91	12.8	7.91	6.67	14.3
Portugal	− 13.9	Oct	− 10.5	Oct	na	na	89.4	89.6	227	217	323	200	169	-1.7

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.

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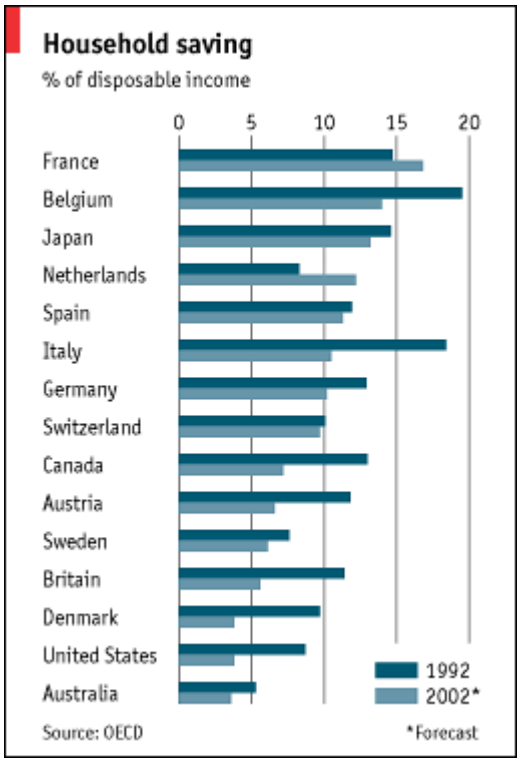
About sponsorship

Household saving

Jan 24th 2002
From The Economist print edition



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Overview

Jan 24th 2002
From The Economist print edition

Industrial production continues to fall in many emerging economies. **Argentina's** industrial output plunged by 18.3% in the 12 months to December. Over the same period, **Taiwan's** industrial production dropped by 6.1%, as exports tumbled, and **Poland's** fell by 4.8%.

Hong Kong's 12-month rate of consumer-price deflation eased to 1.2% in December, but **Singapore's** deflation deepened to 0.6% in the same month.

Chile's 12-month trade surplus narrowed to $1.4 billion in December. **Peru's** 12-month deficit shrank to $149m in November. The Peruvian government plans to return to the international capital markets within the next few weeks. This will be its first sovereign-bond issue since 1928.

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The Economist poll of forecasters

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From The Economist print edition

Every three months, *The Economist* polls a group of economic forecasters and calculates the average of their predictions for growth and current-account balances in 25 emerging economies. Our panellists have become gloomier of late. Compared with October 2001, their forecasts for economic growth this year have fallen in 19 countries. The outlook for Argentina is bleakest: GDP is expected to fall by 4.7% in 2002, after a 3.3% drop in 2001.

January

	Real GDP % change		Current account % of GDP	
	2001	2002	2001	2002
China	7.3	7.1	1.0	0.5
Hong Kong	-0.3	1.8	4.6	4.2
India	5.0	5.5	-0.8	-0.7
Indonesia	3.1	3.3	3.3	2.2
Malaysia	0.0	2.8	6.8	6.1
Philippines	2.8	2.9	4.8	4.7
Singapore	-2.5	1.8	24.2	21.6
South Korea	2.5	3.8	2.3	1.9
Taiwan	-2.3	1.8	5.0	4.0
Thailand	1.7	2.4	4.3	4.0
Argentina	-3.3	-4.7	-1.9	0.1
Brazil	1.6	2.0	-4.7	-4.0
Chile	3.1	3.5	-2.0	-2.0
Colombia	1.7	2.3	-2.5	-3.4
Mexico	-0.5	1.3	-3.0	-3.2
Peru	0.5	3.5	-2.5	-2.6
Venezuela	2.8	1.2	4.0	-0.2
Egypt	2.9	2.7	-2.4	-2.1
Israel	0.0	2.0	-2.9	-2.6
South Africa	2.1	2.4	-0.5	-0.8
Turkey	-8.0	2.7	0.9	0.2
Czech Republic	3.5	3.2	-4.9	-4.9
Hungary	3.9	3.6	-2.0	-2.5
Poland	1.3	1.9	-4.5	-4.2
Russia	5.3	3.8	12.2	5.7

Sources: ABN Amro; Deutsche Bank; Economist Intelligence Unit; Goldman Sachs; HSBC; ING Barings; J.P.Morgan Chase; Merrill Lynch; Salomon Smith Barney; UBS Warburg.

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Economy

Jan 24th 2002
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	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.0	Q3	+ 8.7	Dec	– 0.3	Dec	+22.6	Dec	+20.5	2000	206.5	Oct
Hong Kong	– 0.3	Q3	– 7.1	Q3	– 1.2	Dec	–11.9	Nov	+ 8.8	Q3	111.2	Dec
India	+ 5.3	Q3	+ 0.9	Nov	+ 4.9	Nov	– 5.7	Nov	– 0.7	Q3	45.2	Dec
Indonesia	+ 3.5	Q3	+ 3.2	Q2	+12.6	Dec	+25.4	Nov	+ 4.0	Q3	27.3	Nov
Malaysia	– 1.3	Q3	– 4.4	Nov	+ 1.2	Dec	+14.5	Nov	+ 7.4	Q3	29.8	Oct
Philippines	+ 2.9	Q3	– 0.2	Oct	+ 3.9	Dec	+ 3.4	Nov	+ 5.1	Sep	12.2	Oct
Singapore	– 7.0	Q4	–13.6	Nov	– 0.6	Dec	+ 5.2	Dec	+22.1	Q3	75.8	Dec
South Korea	+ 1.8	Q3	+ 4.9	Nov	+ 3.2	Dec	+ 9.5	Dec	+ 9.9	Nov	101.6	Nov
Taiwan	– 4.2	Q3	– 6.1	Dec	– 1.7	Dec	+15.7	Dec	+16.2	Q3	122.2	Dec
Thailand	+ 1.5	Q3	+ 0.1	Nov	+ 0.8	Dec	+ 2.3	Nov	+ 6.1	Nov	32.6	Nov
Argentina	– 4.9	Q3	–18.3	Dec	– 1.5	Dec	+ 5.6	Nov	– 8.4	Q2	18.1	Oct
Brazil	+ 0.3	Q3	– 2.0	Nov	+ 9.4	Dec	+ 1.6	Nov	–24.4	Nov	37.2	Nov
Chile	+ 2.6	Q3	+ 4.9	Nov	+ 2.7	Dec	+ 1.4	Dec	– 1.7	Q3	14.2	Nov
Colombia	+ 1.0	Q3	– 1.1	Oct	+ 7.7	Dec	+ 0.7	Oct	– 1.2	Q3	10.3	Dec
Mexico	– 1.6	Q3	– 3.7	Nov	+ 4.4	Dec	– 9.9	Nov	–16.6	Q3	43.4	Oct
Peru	+ 1.7	Nov	+ 2.6	Oct	– 0.1	Dec	– 0.1	Nov	– 1.4	Q3	8.8	Oct
Venezuela	+ 2.8	Q3	+ 7.9	Oct	+12.3	Dec	+13.7	Q3	+ 4.4	Q4	9.4	Nov
Egypt	+ 6.5	2000†	+ 9.4	2000†	+ 2.3	Oct	– 8.5	Sep	nil	Q3	13.8	Sep
Israel	– 2.7	Q3	– 7.3	Oct	+ 1.4	Dec	– 7.1	Dec	– 3.6	Q3	22.9	Dec
South Africa	+ 0.1	Q3	+ 4.1	Nov	+ 4.3	Nov	+ 4.8	Nov	+ 0.3	Q3	6.1	Nov
Turkey	– 7.1	Q3	–13.9	Nov	+68.5	Dec	–13.4	Oct	+ 0.9	Oct	18.5	Nov
Czech Republic	+ 3.2	Q3	+ 6.6	Nov	+ 4.1	Dec	– 3.1	Dec	– 2.6	Q3	14.3	Dec
Hungary	+ 3.7	Q3	– 0.8	Nov	+ 6.8	Dec	– 1.8	Nov	– 0.8	Nov	11.2	Nov
Poland	+ 0.8	Q3	– 4.8	Dec	+ 3.6	Dec	–11.8	Nov	– 7.2	Nov	25.2	Nov
Russia	+ 4.9	Q3	+ 2.6	Dec	+18.8	Dec	+52.3	Nov	+41.5	Q3	33.3	Nov
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+ 5.0	Jul	+ 2.7	Nov	– 1.0	Nov	+ 0.3	2001†	2.4	Oct
Saudi Arabia	+ 4.5	2000§	na		– 0.3	Oct	+50.9	2000	+15.6	2000	17.6	Nov

*Excluding gold, except Singapore; IMF definition. †Year ending June. § Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; Russian Economic Trends.

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Financial markets

Jan 24th 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jan 23rd		Dec 31st 2000	
	Jan 23rd	year ago	Jan 23rd	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	11.8	na	1,506.6	-2.2	-31.3	-31.3
Hong Kong	7.80	7.80	11.1	1.87	10,762.1	-1.8	-28.7	-28.7
India	48.2	46.4	68.7	6.71	3,373.1	+0.7	-15.1	-17.8
Indonesia	10,400	9,400	14,826	17.66	434.0	+2.5	+4.2	-3.0
Malaysia	3.80	3.80	5.42	3.30	688.6	-1.7	+1.3	+1.3
Philippines	51.7	48.5	73.6	8.38	1,317.4	+10.3	-11.9	-14.7
Singapore	1.84	1.74	2.62	1.00	1,666.4	-0.5	-13.5	-18.4
South Korea	1,331	1,269	1,897	4.74	742.6	+4.5	+47.2	+39.9
Taiwan	35.0	32.6	50.0	2.60	5,769.8	+5.1	+21.6	+14.8
Thailand	44.2	43.1	63.0	2.38	326.9	+2.3	+21.4	+19.3
Argentina	1.75**	1.00	2.50	na	438.9	na	+5.3	-40.1
Brazil	2.38	1.96	3.40	19.05	13,232.1	+1.1	-15.2	-30.6
Chile	672	568	958	5.27*	5,263.6	-0.3	+8.1	-7.7
Colombia	2,237	2,253	3,189	11.30	1,166.2	+7.1	na	na
Mexico	9.15	9.73	13.0	6.78	6,782.8	+3.1	+20.0	+26.1
Peru	3.46	3.53	4.93	3.03	1,261.9	+1.3	+4.4	+6.4
Venezuela	763	700	1,088	20.14	6,489.5	+0.3	-4.5	-12.4
Egypt	4.63	3.86	6.60	7.22	5,163.6	-2.0	-32.6	-43.3
Israel	4.61	4.15	6.56	2.22	434.4	-1.8	-12.2	-22.9
South Africa	11.4	7.88	16.2	10.25	10,341.7	-3.0	+24.2	-17.3
Turkey	1,365,000	677,540	1,945,944	54.00	12,910.2	+1.2	+36.8	-32.8
Czech Republic	36.3	37.9	51.7	4.48	416.8	+3.6	-12.9	-9.7
Hungary	275	287	392	8.88	7,985.2	+3.7	+1.7	+4.3
Poland	4.10	4.10	5.85	10.80	16,020.1	+2.3	-10.2	-9.5
Russia	30.6	28.4	43.6	25.00	296.0	+4.6	+120.4	+106.5
EMF (MSCI)‡	1.00	1.00	1.43	na	324.9	+1.9	na	-2.6
EMBI+§	1.00	1.00	1.43	na	206.5	+1.4	na	+2.3

*Inflation adjusted. †In $ terms. ‡Emerging Markets Free. §J.P. Morgan Chase's Emerging Markets Bond Index Plus. **Fixed official rate 1.40.
Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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